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Maintenance of Value - Correspondence 02

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4

OFFICE MEMORANDUM

7 18/3/81

TO: Mr. Joe Wood, FPA

DATE: January 29, 1981

FROM: Heribert Golsong *HG*SUBJECT: Valuation of IBRD Capital Subscriptions --
Possible Courses of Action

On my return from New Zealand I had an opportunity to read the excellent draft dated January 21.

As to the procedural issue mentioned in your covering note I would favor pursuing first the discussions within the G-6, provided, however, that a meeting of the G-6 group can be materialized within the near future, that is the first half of March, as presently suggested by the French authorities.

As to the substance of the draft memorandum, I would suggest a somewhat different presentation of available options, such as:

- (i) substitution of the 1944 gold dollar by SDR;
- (ii) substitution of the 1944 gold dollar by the current US dollar;
- (iii) a combination of one or the other of the above-mentioned options with the system of qualified subscriptions as described in paragraphs 50 et seq. of your memorandum.

I have strong reservations as to the presentation of the multiple currency scheme without variable adjustments as one of the available options under the present Articles of Agreement. As you know, I am of the opinion - I will substantiate this opinion in a formal way - that the valuation of IBRD capital subscriptions by way of interpretation has to remain based on a common standard of value. The multiple currency scheme described in paragraphs 34 et seq. could only be introduced by way of amending the Articles. I would, therefore, strongly urge to delete the presentation of the multiple currency scheme as one of the possible options under the interpretation power. If it were decided to maintain discussion of this option, paragraph 43 has to be amended to the effect that, according to the General Counsel's opinion, it is not possible to implement the multiple currency scheme by way of interpretation. A similar amendment would be necessary in the last sentence of paragraph 56.

A last word. I wonder why the memorandum uses sometimes the expression "strong common standard of value" and in other instances just "common standard of value". In my view, the latter expression is sufficient.

cc: Members of the Finance Committee
Mr. Chenery
Mr. Scott

01/29

Label the items clearly & describe them

Office of the President

- I will know - covered part?
- II SRR - winter (both A & B?)
 - a. No limit on shares
 - b. with limit on shares
- III \$ - ~~policy~~ (not discussed)
- IV Banked - covered - ~~policy~~ (rigidly)
 - not "temporary" ceiling

Should we say IV will be good
 on every regard
 (common means that everyone
 equally ~~is~~ interested with
 as opposed to diff. interests & differences
 Or not see I - possible words

718/3/2

OFFICE MEMORANDUM

TO: Members of the Finance Committee

DATE: January 21, 1981

FROM: Joe Wood ^{2/3/81}

SUBJECT: Valuation of IBRD Capital Subscriptions
Possible Courses of Action

Please find attached a draft Board memorandum on the valuation of the Bank's capital.

A meeting on this draft will be scheduled shortly. One of the issues to be considered is whether it is desirable to go forward with a Board memorandum on this subject at this time or whether instead we should pursue the discussion within the G-6.

Attachment
cc: Mr. Chenery

*note clipped pages
simplify by omitting the
substantially addressing
Sec 5 (modifications)
ck informally with G6
not to discuss the paper
but to inform each other
are sending paper to
the G6 -*

*Current as a
Discussion Draft*

or the curr 45

1. What is the basis for the view that the SDR can be substituted for the 1947 470 amendment but 5 curr counts is there a clause giving the Bd power to interpret the articles when the conditions are not or implied in them change.

2. Pg 4 footnote v: what would be the 190V settlements signed up 24/1/78 by country

3. Breakdown of 8.4 by country

4. Pg 23 - prepare a note for me describing the Bretton Woods Fund multiple curr. sys.

DRAFT

January 19, 1981

MEMORANDUM TO THE EXECUTIVE DIRECTORS

SUBJECT: Valuation of IBRD Capital Subscriptions:
Possible Courses of Action

Section 1: Introduction

1. The problem of IBRD Capital valuation has two main aspects: The first concerns the standard of value in which members' subscriptions to the Bank should be denominated. Until 1978, the Bank had an unequivocal common standard of value for all shares regardless of the subscribing member or the date on which the shares were subscribed. This common standard was the par value per share established in the Bank's Articles, namely, "100,000 United States dollars of the weight and fineness in effect on July 1, 1944" (the so-called 1944 gold dollar). 1/ And, while the Articles permit the Bank to issue shares at a subscription price other than par, 2/ the Bank consistently followed the practice of issuing all shares at par, thereby establishing an identical obligation on every share of \$100,000 (in gold dollars), regardless of what happens to the exchange rates of member countries.

1/ Articles II, Section 2 (a).

2/ Article II, Section 4.

2. For several years, the Bank has not been able to state with precision what members' obligations are on existing shares or to fix an unequivocal subscription price for new shares. The difficulty in applying the provisions of the Articles with respect to capital stock arose when it became clear that the reform of the international monetary system would result in the removal of gold as the basis for determining the par values of national currencies. The main problem has centered on what the Bank should use as a successor to the 1944 gold dollar, which ceased to exist on April 1, 1978 when the Second Amendment of the IMF Articles took effect. In 1976 (and again in 1978), the Vice President and General Counsel gave an opinion that the SDR would be a logical successor to the 1944 gold dollar and that it could be substituted for purposes of the Bank's capital subscriptions without an amendment of the Articles. 1/ It was acknowledged, however, that the Executive Directors might also decide that the current United States dollar could also serve as a successor. Moreover, the appropriateness of settling this issue by a decision of the Executive Directors rather than by amendment of the Articles was questioned by a member country. And although the choice of successor to the 1944 gold dollar had not been resolved, subscriptions continued to be received in 1978-80 under the 1976 Selective Capital Increase.

1/ "Valuation of the Bank's Capital" (SecM76-423, dated June 8, 1976); and "Valuation of the Bank's Capital" (SecM78-251, dated March 29, 1978).

It was necessary, therefore, to adopt an interim arrangement for that Increase whereby subscriptions were accepted at a price per share of either SDR100,000 or \$120,635 (the current US dollar equivalent of the 1944 dollar at the last official par value of the dollar), subject to adjustment once the valuation issue is settled.

3. The need to resolve the question of how to value the Bank's capital has become more urgent as the time for the start of subscriptions to the General Capital Increase (GCI) draws near. The GCI resolutions contain provisions for adjusting the number of shares issued under the resolutions, depending on whether SDR100,000 or \$120,635 per share is determined to be the subscription price of GCI shares. Several member governments have expressed strong reservations about subscribing to the GCI before a final decision is taken on this issue.

4. The second aspect of the capital valuation problem relates to the provisions in the Bank's Articles that require members to maintain the value of that portion of their paid-in capital that is subscribed in their own currency, using the subscription price (i.e., 100,000 gold dollars) as the measure of their liability. 1/ Problems in applying the maintenance of value (MOV) provisions, which require members (or the Bank) to make payments of national currency whenever

1/ Article II, Section 9.

the exchange rates change between national currencies and the standard of value, actually predate the difficulty in establishing a successor to the 1944 gold dollar. In the early 1970s, when floating exchange rates became common, the Bank began to examine new approaches to the settlement of these obligations. Previously, the application of the MOV provisions had been relatively straightforward: a member (or the Bank) made MOV payments only when an explicit decision was made to change the par value of the member's currency. 1/ Floating complicated MOV because exchange rates changed without any corresponding changes in official par values. Discussion of a new method for settling MOV obligations was never brought to a conclusion, because the amendment of the IMF Articles made the Bank's existing standard of value unusable, and without an agreed replacement the MOV provisions of the Articles could not be applied. If the question of the replacement of the 1944 gold dollar can be resolved--and this is clearly the more difficult issue--it should not be difficult to develop a satisfactory technique for settlement of MOV obligations. 2/

1/ The Articles of Agreement also permit the Bank to require MOV payment if it finds that a de facto depreciation has taken place. This provision has only been applied in special circumstances.

2/ In its published accounts, the Bank has been accruing "notional MOV" against the SDR since April 1, 1978. As of December 31, 1980, notional MOV payable to the Bank was \$468.1 million; the Bank's own notional MOV obligation was \$130.8 million, leaving a net amount due to the Bank of \$337.3 million. The positions of individual members with respect to MOV obligations prior to April 1, 1978 vary widely. Some have settled on the basis of the last par values of their currencies; others have not settled MOV since the early 1970s.

5. The Bank is thus now faced with the task of determining in the near future: (a) what the standard of value for capital subscriptions should be, i.e., what the successor to the 1944 gold dollar should be; and (b) whether and how the maintenance of value provision in the Bank's Articles should be applied.

6. This memorandum is intended to provide a basis for consideration of these issues. It describes three options that might be applied to future capital subscriptions. One would be to do away with a standard of value altogether, letting each member subscribe to the Bank in terms of its own national currency. This option is analyzed first (in Section 2) in order to make clear at the outset the purposes that a standard of value has served in the Bank in the past. The advantages and disadvantages to both the Bank and its members are described. A distinction is made between a strong standard of value, which brings important financial benefits to the Bank, and a common standard of value, which preserves the important principle that countries' rights in the Bank should correspond to the obligations they carry.

7. Section 3 discusses the option that was put forward by the General Counsel in 1976, namely, the simple substitution of the SDR for the 1944 gold dollar. If done by interpretation rather than

amendment, this option would be easy to implement and would ensure that the Bank continues to have a standard of value that is both relatively strong and common to all members. Section 4 describes a third option, which is to have a multiple currency standard of value. Under this option, members would be given a choice of the SDR or any of its constituent currencies as the standard of value for their capital subscriptions, in recognition of the fact that as a practical matter the successor to gold has been not so much the SDR as a multiple reserve currency system.

8. While either ^{the second or third} of ~~these~~ options would be better for the Bank's finances than abolition of a standard of value altogether, they both have drawbacks from the standpoint of at least some member countries. Substitution of the SDR as the Bank's standard of value in a world of floating exchange rates would retain a system under which contingent liabilities (i.e., callable capital obligations) for the Bank's shareholders are variable in terms of members' national currencies. Paid-in capital obligations would also be variable; frequent and sometimes offsetting MOV payments could in principle be required. Section 5 discusses ways of mitigating such effects on member countries, including a variant of the SDR option under which member countries could be permitted to set a temporary ceiling on the national currency value of their total contingent liability to the Bank (i.e., the total of their uncalled capital).

9. Section 5 also describes ways in which the multiple currency option could be modified in order to make it more attractive to countries whose currencies are not part of the SDR and to prevent undue erosion of the correspondence between relative rights and relative obligations.

10. Section 6 discusses the options available to the Bank with respect to existing (as opposed to future) capital subscriptions. Section 7 provides a summary and conclusions.

Section 2: Abolition of a Standard of Value

11. The initial standard of value (i.e., the 1944 gold dollar) has served two main purposes in the Bank: protection of the Bank's financial strength; and preservation of a correspondence between relative subscriptions and relative voting power. 1/

Effect on Bank Financial Strength

12. Historically, the standard of value has helped preserve the real value of IBRD capital by linking subscriptions to a unit (effectively gold) that was strong relative to the national currencies of members subscribing to the Bank and the currencies in which Bank operations conducted. It is estimated that the Bank's subscribed capital would have been about \$8.4 billion (or 21%) lower at the end of FY80 if members' subscriptions had been denominated in their own currencies rather than in a common standard of value. 2/ Similarly, if exchange rate movements in the future continue as they have in recent years, 3/ abolition of a standard of value altogether could result in future reductions in subscribed capital of \$11 billion over

1/ Under the Bank's Articles, relative shareholdings also determine member's relative claims on the Bank's earnings and assets (in a liquidation).

2/ The calculations underlying this estimate use the 1944 gold dollar as the standard of value until April 1, 1978 and the SDR thereafter.

3/ Specifically, as they did between 1974 and 1979.

the next 4-6 years, compared to what would be the case if the SDR were substituted for the 1944 dollar. Both the Bank's bondholders and its borrowing member countries benefit from the stronger capital base provided by a strong standard of value, but in somewhat different ways.

13. Bondholders. One of the main protections for holders of World Bank bonds is the callable capital guarantees provided by the shareholder governments. Under the Bank's Articles, this callable capital is to be paid (in the event of a call) in gold, dollars or in the currencies needed to meet the Bank's obligations. 1/ However, the value of the callable capital is not expressed in terms of the currencies that would be needed in the event of a call, but in terms of the unit in which the capital subscriptions are denominated (i.e., the subscription price per share). If this unit is a strong unit of value relative to the currencies in which borrowings are made, the risk to the Bank and its bondholders of a depreciation in the value of the callable capital vis-a-vis the funded debt will be minimized. If the subscription price is expressed in terms of a relatively weak unit

1/ The balance of the paid-in capital would most likely also be called at the time of a call on the callable capital. The Articles provide for 2% of the subscription price to be paid in gold or dollars, and 18% in the member's own currency. At present, only one-half of these amounts have been paid (i.e., 1% and 9%) and in the General Capital Increase, only three-eighths of the total paid-in capital obligation will be paid at the time of subscription (i.e., 3/4% and 6-3/4%), with the balance to remain "uncalled" until needed.

of value, then bondholders face the prospect of an erosion over time in the value of the callable capital guarantees.

14. Without a standard of value, the exposure of the bondholders to a depreciation in the callable capital can be determined by comparing two currency baskets: the basket in which borrowings have been made and the subscribed capital basket. The basket of borrowings has consistently appreciated vis-a-vis the subscribed capital basket because most borrowing has taken place in a few strong currencies, whereas the capital is made up of the subscriptions of a much wider number of currencies, many of which are quite prone to depreciation. With a standard of value, the relevant comparison is between the effects of exchange rate changes on the basket of borrowings and their effects on the standard of value. For example, if the standard were the Bank's unit of account (the US dollar) the value of the callable capital would move against the Bank's debt in the same way that the dollar does, i.e., as though all subscriptions were made in dollars. If the SDR were the standard, the relevant comparison would be between the basket of borrowed currencies and the SDR basket.

15. The importance of a strong standard of value to bondholders is reduced to the extent that bondholders look for protection mainly to the callable capital of the more creditworthy countries, whose currencies tend to be somewhat stronger on average than the total subscribed capital basket. 1/

16. Lending Authority. The Bank has also derived benefits from the effects of a strong standard of value on commitment authority. The Bank's Articles of Agreement put a statutory ceiling on

1/ Because of its effects on paid-in capital, a strong standard of value also produces a marginal strengthening of the Bank's net income and equity, which provides some additional benefit to bondholders. This effect is marginal, however, because the currency composition of paid-in capital that is released for use in the Bank's operations (which is all that affects the Bank's income) is considerably stronger than the basket of subscribed capital generally.

outstanding loans equal to the total of subscribed capital and reserves. In calculating this statutory limit on lending, the full amount of capital subscriptions is taken into account. Thus, the absence of a standard of value since the Bank's inception would have resulted in about \$8 billion less commitment authority at the end of FY80 than the Bank actually had.

17. In recent years, most of this hypothetical loss of commitment authority would have occurred because of depreciation of the subscriptions of the Bank's borrowing members as a group. Depreciation of members' currencies within the group of Part I countries was offset by appreciation of other Part I currencies. However, having a strong standard of value has placed little or no cost on the developing countries, who have the greatest interest in preserving the Bank's commitment authority. This is because (a) the major part of subscriptions to the Bank are in the form of a contingent liability that does not, and is never expected to, impose a real cost on member countries; and (b) many of the Part II countries have not released the national currency portion of their paid-in capital. 1/

1/ Apart from the 1% of subscriptions that is paid in gold or dollars (3/4% in the GCI) paid-in capital becomes a burden on the foreign exchange resources of a member country only when it is released by the member for use in the Bank's operations.

Subscriptions and Voting Power

18. The second purpose a standard of value achieves in an institution like the Bank is that, if it is common to all members, it ensures that there will be a correspondence between members' relative obligations (i.e., capital subscriptions) and their relative rights (i.e., voting power). The framers of the Bank's Articles saw this as an important principle and established the Bank as a share capital institution with each share having the same rights and obligations. Moreover, since all shares have been issued at the same purchase price (i.e., par) differences in burden-sharing ability (measured in the case of the bank largely by Fund quotas) have been taken into account through the number of shares allocated to various members, and differences in voting power have matched differences in share allocations. 1/

19. The existence of a single, common standard of value ensures that this parallel distribution of votes and obligations remains unchanged over time regardless of what happens to exchange rates. That is, the proportions of total subscribed capital obligations held by various members will remain as they were at the time shares were

1/ This contribution-weighted voting is tempered in the Bank by the membership votes (or "membership shares" in the case of GCI), but the overall result is one in which each member has approximately the same proportion of total voting power as it has of total subscriptions.

allocated, and they will continue to correspond to the proportions of shares and votes (subscription votes, that is) held by the same members. Doing away with a common standard would permit exchange rate movements to cause the distribution of capital obligations to diverge both from what it was at the time the shares were allocated and also from the distribution of shares and votes, which would remain as originally agreed. This process, which is illustrated in the table below, would result in members having different obligations per share and thus a mismatch between relative obligations and relative rights.

Hypothetical Impact of Exchange Rate Movements on Relative Subscriptions and Voting Power with and without a Common Standard of Value

With Common Standard of Value

add for entries

	Ex-change Rates ^{a/}	Initial Position				Position after Exchange Rate Changes				
		SDR	National Currency	% Total ^{b/}	Voting Power ^{c/} (%)	Ex-change Rates ^{a/}	SDR	National Currency	% Total ^{b/}	Voting Power ^{c/} (%)
Country A	2.00	1,000	2,000	41.7	41.7	1.80	1,000	1,800	41.7	41.7
Country B	1.00	600	600	25.0	25.0	1.25	600	750	25.0	25.0
Country C	.75	300	225	12.5	12.5	.70	300	210	12.5	12.5
Country D	5.00	300	1,500	12.5	12.5	4.00	300	1,200	12.5	12.5
Country E	10.00	200	2,000	8.3	8.3	25.00	200	5,000	8.3	8.3
		<u>2,400</u>		<u>100.0</u>	<u>100.0</u>		<u>2,400</u>		<u>100.0</u>	<u>100.0</u>

Without Common Standard of Value

	Ex-change Rates ^{a/}	Initial Position				Position after Exchange Rate Changes				
		National Currency	SDR ^{d/}	% Total ^{b/}	Voting Power (%)	Ex-change Rates ^{a/}	National Currency	SDR ^{d/}	% Total ^{b/}	Voting Power (%)
Country A	2.00	2,000	1,000	41.7	41.7	1.80	2,000	1,000 480	46.9	41.7
Country B	1.00	600	600	25.0	25.0	1.25	600	480	20.3	25.0
Country C	.75	225	300	12.5	12.5	.70	225	321	13.6	12.5
Country D	5.00	1,500	300	12.5	12.5	4.00	1,500	375	15.8	12.5
Country E	10.00	2,000	200	8.3	8.3	25.00	2,000	80	3.4	8.3
			<u>2,400</u>	<u>100.0</u>	<u>100.0</u>			<u>2,367</u>	<u>100.0</u>	<u>100.0</u>

20. The potential for disparities to develop is greater in the case of the Bank than in (e.g.) IDA, because the obligation that a member incurs in subscribing to the Bank is mainly in the form of a contingent liability, whereas in IDA contributions are paid-in and committed in a relatively short period of time. That is, the important decisions to be made with respect to IDA resources are made within a relatively short period of time after agreement is reached on relative burdens and relative voting power. The main portion of IBRD capital subscriptions, on the other hand, remains outstanding (i.e., uncalled) indefinitely, and protecting the relationship between control of resources and the responsibility to provide resources, if needed, from the affects of exchange rate movements over a long period of time is therefore more important in the Bank than in a institution like IDA.

21. These considerations suggest that a common standard of value would continue to offer benefits for the Bank's bondholders, borrowers, and shareholders. If such a standard is also a relatively strong currency unit, it will serve to protect the Bank's commitment authority and other aspects of its financial strength. It is these considerations which constitute the case for continuing with a standard of value system; that is, adopting a single, strong successor to the 1944 gold dollar.

22. The case against adopting a common standard of value is partly based upon the legislative and administrative inconvenience that is imposed on members by acceptance of an obligation denominated in something other than their national currency. But there is also a point of principle involved. When new allocations of shares are agreed--as for example, at the time of selective capital increase--the allocations take account of many factors. Subscribing countries naturally feel that these allocations, and particularly the relative voting power associated with the allocations, should not be changed except after careful review and renegotiation based upon the same broad range of factors. This point, however, can be used either to argue in favor of a common standard of value or to argue against it. As noted above, the Bank has in the past operated on the principle that because relative voting powers should not be changed except by negotiation, relative obligations should also not change except by negotiation. Adherence to a common standard of value has prevented exchange rate changes from altering relative obligations and hence creating a situation where relative voting power would need to change.

I don't understand the point about following

23. Those opposing a common standard of value also believe that voting power should be changed only as a result of negotiation but reach precisely the opposite conclusion with respect to the effects of exchange rate changes on relative obligations. While they acknowledge that, absent a common standard of value, exchange rate changes will alter relative subscriptions, they argue that this change alone should not force a realignment of voting power--at least not automatically.

but this argument

They would, in other words, tolerate discrepancies between relative subscriptions and relative voting power that arise because of exchange rate changes. These discrepancies could be taken into account--as one factor, but not the only one--in determining the allocation of new shares. They would not, however, tamper with the allocation of existing shares solely because exchange rate changes had altered relative obligations.

24. The differences between these two points of view reflect differing value judgments about the importance of keeping relative votes in line with relative subscriptions. Those who attach major importance to maintaining a fixed relationship between obligations and voting power over time may prefer the substitution of the SDR for the 1944 gold dollar, an option that is described in the next section. The multiple currency option, which might be viewed as a compromise between a single, common standard of value and no standard at all, is discussed in Section 4. Section 5 describes ways in which both options can be made to achieve somewhat similar results.

Section 3: Substitution of the SDR

25. Substitution of the SDR for the 1944 gold dollar as the Bank's common standard of value, leaving the provisions of the Articles relating to the par value of the capital stock and MOV on paid-in capital, was suggested by the General Counsel in 1976. ^{1/} In brief, the General Counsel concluded that the SDR was the logical successor to the 1944 dollar and could be substituted for the 1944 dollar using the Executive Directors' powers to interpret the Articles, i.e., amendment was unnecessary. It was presumed at the time that member governments would prefer to avoid an amendment if possible, and leave the provisions of the Articles relating to capital stock as they presently are.

26. If the SDR were substituted for the 1944 dollar, the par value of a share of IBRD capital stock would become SDR100,000, and members' obligations with respect to both paid-in capital and callable capital would be defined in terms of SDR. In the General Capital Increase, for example, member countries would be required to pay in 3/4% of the subscription price per share of SDR100,000--i.e., SDR750 --in gold or dollars and 6-3/4% in their own national currency--i.e., the national currency equivalent of SDR6,750 at the exchange rate prevailing on the date payment is received. In addition, members

^{1/} See: "Valuation of the Bank's Capital" (SecM76-423, dated June 8, 1976), and "Valuation of the Bank's Capital" (SecM78-251, dated March 21, 1978)

would be expected to recognize a contingent liability of SDR92,500 per share. If a call was ever made on the GCI shares, each member would be expected to pay up to the equivalent of SDR92,500, depending on the amount of the call. 1/ From time to time, the member (or the Bank) would also be required to make payments of national currency in order to maintain the value of the 6-3/4% portion of paid-in capital at its SDR value of SDR6,750 per share.

27. The preceding section discussed the benefits to the Bank's bondholders, borrowers and the shareholders themselves that would arise from use of a strong and common standard of value for capital subscriptions. These benefits would, however, involve what may be perceived as a cost to the shareholders, namely, acceptance of an obligation expressed in something other than their own national currency. This cost has two components: (a) the administrative and legislative problems created by MOV on paid-in capital; and (b) the policy and other problems associated with a contingent liability whose value in the member's own currency changes with day-to-day movements in exchange rates.

1/ More specifically, up to 1-1/4% (i.e., SDR1,250) of the subscription price would be payable in gold or dollars, 11-1/4% (i.e., SDR11,250) in the member's own currency and 80% (i.e., SDR80,000) in gold, dollars or the currencies needed to meet the Bank's obligations.

28. Paid-in Capital. Several different problems are created for members by use of a common standard of value for IBRD capital subscriptions. The first concerns the number and size of MOV transactions that could result under a system of floating exchange rates. Technically speaking, MOV obligations to (or from) the Bank would arise on a daily basis for many members, stemming from daily movements of exchange rates. These obligations could also fluctuate in value, sometimes flowing from the member to the Bank (when the member's currency depreciates against the SDR) and sometimes from the Bank to the member (when the member's currency appreciates against the SDR). Fortunately, the Bank has very wide latitude in arrangements for settlement (i.e., payment) of MOV obligations, subject only to considerations of equity among members and prudence in financial policy. MOV obligations might be accrued for 12 months at a time, for example, and then settled anytime within the subsequent five years.

29. A more serious problem with respect to paid-in capital obligations that are expressed in terms of the SDR is that members would not know at the time ~~in~~ a capital increase is agreed how much national currency will be required to purchase a share of IBRD capital stock. This will depend on what happens to the member's exchange rate vis-a-vis the SDR between the time the increase is agreed and the time the shares are actually subscribed. The legislative process of appropriating amounts for IBRD capital subscriptions will thus be more complicated than if the subscription were expressed in national currency. Moreover, even after subscription has been made, some

members might need to take legislative action from time to time in order to maintain the 9% funds at their initial value. This could present particularly difficult problems in cases where the member's currency depreciates steadily against the SDR, in that a sustained budgetary burden would then arise.

30. It may be worth noting in this context that none of these problems are unique to an SDR standard. The same problems existed previously when the 1944 gold dollar was the Bank's standard of value, but they arose less frequently - because exchange rates changed less frequently - and they were normally encountered only as part of an explicit decision by the member government to change its currency's official par value.

31. Callable Capital. As noted in the preceding section, expressing IBRD capital subscriptions in terms of SDR would provide important financial benefits to the Bank because of its effect on the long-term value of the callable capital guarantees. The cost to shareholders of providing callable capital in SDR rather than national currency is not financial - because there is no expectation of a call even being made - but administrative. If expressed in SDR, subscriptions to the Bank would carry a contingent liability that is unknown in terms of the member's own currency. While this results in only minor inconvenience for some members, others, as a matter of law or policy, are extremely reluctant to accept an IBRD callable capital

obligation expressed in something other than their own currency. Difficulties tend to be greater for those countries with more extensive legislative procedures applying to their Bank subscriptions.

32. For example, if a member insists on full advance appropriation of the callable capital in national currency, then an SDR standard of value (on any standard other than the member's own currency) could result in legislative and administrative problems on callable capital similar to those affecting paid-in capital. Most members do not appropriate the full amount of callable capital. The position of one major shareholder that did so in the past is unclear at present. *change*

33. This problem also existed in the past with the 1944 gold dollar as a standard of value. However, under the par value system it was possible for members to make the change in the national currency value of their contingent liability to the Bank a part of legislative and other actions needed to change the par value of their currency.

Section 4: Multiple Currency Standard

34. A third option would be to seek to retain the advantages of a strong standard of value, but to give members a choice of currencies in which they can subscribe. This approach would reflect the fact that in economic terms the successor to gold has not been the SDR but rather a multiple reserve currency system in which any or all of several national currencies act as international standards of value. Under this option, which is modelled on the arrangements agreed in the UNCTAD Common Fund, all members would gain slightly greater flexibility in subscribing to Bank capital stock. More importantly, a multiple currency standard would eliminate the administrative and legislative burdens of an IBRD standard of value for some important shareholders who have the greatest problems in accepting an obligation expressed in something other than their own currency.

35. One way to apply this scheme would be to permit subscriptions to be made in SDR or in any of the component currencies of the SDR, at exchange rates on a given date. Using the rates in effect on the date of effectiveness of the General Capital Increase resolution, for example, the terms and conditions for GCI subscriptions might be amended to state that the purchase price of a share would be SDR100,000 or any of:

US\$132,108

DM226,631

FF531,140

¥313,757,000

£59,122

Each member would be permitted to choose any of these currency units in which to denominate its subscription under the GCI. Countries whose currencies are included in the SDR basket might perhaps be restricted to a choice of either their own currency or the SDR.

36. If a member country chooses the SDR, its obligations with respect to paid-in and callable capital would be just as described in the preceding section. On the other hand, if it chooses one of the other currencies, its obligations would be expressed in terms of that currency alone. For example, suppose that a country chose to subscribe in DM. It would be required to pay in a total of DM16,997 per share (7-1/2% of the total subscription price per share), of which one-tenth (i.e., 3/4% of the subscription price) would be in gold or dollars and nine-tenths would be in the member's own currency (i.e., the equivalent of DM15,298 or 6-3/4% of the subscription price). Maintenance of value obligations would apply with respect to DM, not SDR. That is, the member (or the Bank) would have an obligation to make MOV payments so as to maintain the national currency portion of the paid-in capital at DM15,298 per share. The callable capital obligation would, of course, also be expressed in DM. In the event of a call, the member would be expected to pay up to the equivalent of

DM209,633 at rates prevailing on the date the call is made.

37. Several questions would appear to be important in considering the merits of this option: (1) What would its likely impact on Bank finances be, compared to the other two options? (2) How would it affect member countries' subscribed capital obligations? (3) What would happen to the relationship between relative burdens and relative rights? (4) What would be required to implement this option?

38. Bank finances. The potential impact of the multiple currency option on the Bank's finances cannot be determined without speculating about the choices member countries are likely to make and the behavior of exchange rates in the future. The outcome is likely to be between the no standard of value option and the pure SDR standard. *possibly very close to the latter.* The SDR component countries (i.e., those whose currencies are in the SDR) may well choose to subscribe in their own currency, and this will change slightly the behavior of their collective portion of capital subscriptions in response to exchange rate movements from what it would be with a pure SDR standard. The following table compares the proportions of these currencies in the SDR and the GCI. As the table indicates, the respective shares in the GCI and SDR are close enough so that one would not expect major differences in the SDR value of this group of countries' subscriptions under either option.

	<u>% Share of Currency in:</u>	
	<u>GCI</u>	<u>SDR a/</u>
US	49.7	42.3
UK	16.6	13.3
France	11.2	12.8
Germany	11.3	18.3
Japan	11.2	13.3

a/ At exchange rates of January 8, 1981.

39. It seems probable that many of the "non-SDR" countries would choose to take advantage of the "hedging" potential of an SDR-denominated subscription and thus choose the SDR as their standard of value, although some might attempt to identify the potentially weakest currency in the SDR basket and subscribe in it. Other countries might choose to link their Bank capital subscription to the currency against which they maintain their exchange rate (e.g., the FF or the US\$).

40. Effect on Members' Obligations. For the five member countries whose currencies make up the SDR basket, this option would offer significant advantages over the "SDR only" option. If they choose to subscribe in their own currency, their subscribed capital obligations would be no different than if a common standard were abolished altogether. Specifically, as compared to the "SDR only" option, these five members would: (a) be able to know at the time a capital increase is agreed what their ultimate national currency obligation would be; (b) be relieved of the need to make maintenance

of value payments with respect to paid-in capital; and (c) have a fully-determined callable capital obligation in terms of their own currency.

41. Other member countries would be in essentially the same position as under the SDR option. Some might gain a degree of flexibility and simplicity by being able to denominate their Bank subscription in the currency (e.g., the US dollar) against which they maintain their exchange rates.

42. Votes and subscriptions. At the time of a review of capital subscriptions, calculations relating to relative shareholdings and the allocation of new subscriptions among members would need to be done in terms of a common numeraire, most likely the SDR. Once this allocation of shares is agreed, members could choose which of six different currency units (the SDR plus its five component currencies) they wish to subscribe, at some agreed set of exchange rates. 1/ At the outset, therefore, all shares could entail the same financial burden for members, whether measured in SDRs, dollars, francs or any other currency. However, once different subscription currencies have been established, the cost per share for the various classes of shares

1/ If all members were to choose as of a certain date, and the exchange rates of that date were used to determine equivalent subscription prices in the five currencies, there would be less risk that exchange rate movements might affect members' choice of a standard of value.

will begin to diverge from each other as exchange rates change. By the time of a subsequent review of capital subscriptions, the divergences from the original equal burden per share could be substantial. 1/ These exchange rate movements would affect not only the relationship between, e.g., the UK and the United States, but also all countries that had selected the pound and the dollar as their standard of value. There could be six groups of countries, each having a different cost per share. The following table gives an illustration of the type of change that could take place in the GCI. The table assumes that the five SDR countries all choose their own currency as the standard of value and that all other countries choose the SDR.

1/ The movement in exchange rates since January 4, 1980 (the date of effectiveness of the GCI) would have produced a differential of about SDR32,000 per share between the highest and lowest value per share (see table in para. 43).

Illustration of Effects of Multiple Currency Standard of Value (SOV)
on Relative Subscriptions and Voting Power in the GCI

Country	Exchange Rates ^{a/}	Initial Position				After Exchange Rate Changes		
		Price per Share		Total Subscription		Exchange Rates ^{a/}	SDR Price per Share	% of Total Subscr. ^{c/}
		In SOV	In SDR	In SOV ^{b/}	% Total			
US	1.32108	132,108	100,000	\$8779.5	21.95	1.27724	103,432	22.30
UK	.59122	59,122	100,000	£1314.2	7.34	.531140	111,312	8.03
France	5.31140	531,140	100,000	FF7977.2	4.96	5.79548	91,647	4.46
Germany	2.26631	226,631	100,000	DM3412.4	4.97	2.50569	90,447	4.42
Japan	313.757	313,757 ^{d/}	100,000	¥4704.8 ^{d/}	4.95	256.087	122,520	5.96
Others	1.000	100,000	100,000	SDR16902.8	55.83	1.0000	100,000	54.83
Total					<u>100.00</u>			<u>100.00</u>

- a/ Number of currency units per SDR. Initial rates are as of January 4, 1980, the date of effectiveness of the GCI resolution. Subsequent changes use rates as of January 8, 1981.
- b/ The amount of the GCI has been set at SDR30,278.3 million (\$40 million divided by 1.32108) and the number of shares has been scaled down to 302,783.
- c/ Measured in terms of a common numeraire (i.e., the SDR).
- d/ Yen figures are in thousands.

43. Implementation of the Option. Unlike the "SDR only" approach it may not prove possible to implement a multiple currency standard of value by using the Directors' powers to interpret the Bank's Articles. ~~Such an interpretation raises serious legal issues~~ ^{that} that require further study. In the end, an amendment of the articles could be necessary. This would make the process of implementation more protracted and possibly more uncertain. If the amendment were to fail, another solution to the capital valuation question would need to be found.

44. If it does prove possible to establish a multiple currency standard of value by interpretation, the "SDR only" option and the multiple currency option would be on the same footing with respect to their implementation requirements. If amendment does turn out to be necessary for the multiple currency option, this might reduce its attractiveness to some member governments.

Section 5: Possible Modifications to the Basic Options

45. As discussed above, the "SDR only" option would establish subscribed capital obligations for all members in a unit of value other than the member's own currency. Under the Bank's Articles of Agreement, adoption of the SDR as the IBRD standard of value would give rise to an obligation to maintain the value of paid-in capital in terms of the SDR and would result in members' having contingent liabilities that are unknown in terms of the member's own currency. Under the multiple currency option, the five largest shareholders in the Bank would not be confronted by the administrative and legislative problems that might be generated by the "SDR only" approach. Other member countries would be in essentially the same situation with respect to the inconvenience of subscribing in SDR, although there might be some administrative benefit for some countries in being able to denominate their subscriptions in one of the SDR currencies. The multiple currency approach would, however, permit exchange rate changes to create a divergence between relative votes and relative obligations.

46. This section discusses ways in which each of these two basic options might be modified in order to reduce or eliminate their respective drawbacks, beginning with the "SDR only" approach.

Modifications to the "SDR Only" Option

47. Paid-in Capital. In Section 3, it was pointed out that the latitude available to the Bank in settlement of MOV could reduce the administrative problems of MOV payments to and from the Bank. Such arrangements would help in situations where the only concern is the number and size of MOV transactions. A more complete solution to the problem some members face with respect to paid-in capital may lie in the use of a provision of the Articles that permits the member country to be relieved entirely of the need to make MOV payments. This approach, which has come to be known as the "Philippines Formula", after the country to which it was first applied, stems from the fact that MOV applies only to the national currency portion of the subscription that is actually held by the Bank. If a member exchanges this national currency with a currency acceptable to the Bank, then there is by definition no further MOV requirement (unless, of course, the transaction is reversed). In earlier years, the Bank permitted the Philippines and several other countries to exchange their national currencies with US dollars as a means of obtaining the release of otherwise unusable subscriptions.

48. This approach could be applied under an SDR (or any other) standard of value by permitting countries to exchange their own national currency with the SDR basket of currencies. Their national currency subscription would thereby become "self-maintaining" in that the value of this portion of their subscription would automatically remain constant in SDR regardless of what happens to the exchange rates among the SDR currencies actually held by the Bank.

49. Traditionally, the "Philippines formula" has only been applied to countries that release their paid-in capital for use in the Bank's operations. Whether or not members should be permitted to make use of this device even though they do not release paid-in capital is a matter of policy. 1/ If the application of the "Philippines formula" were extended to members not immediately releasing paid-in capital upon subscription, then members' exposure to exchange rate changes on paid-in capital would extend only from the date of appropriation to the date of subscription. If the "Philippines formula" continues to apply only to released paid-in capital, members' exposure would continue until the date the paid-in is released for use in the Bank's operations, which could be several years after the date of subscription. Even in this instance, however, it would be possible to defer settlement of MOV until all paid-in had been released.

50. Callable Capital. The administrative and legislative inconvenience created for some members in having a contingent

1/ There is also a legal issue as to whether a note issued by a member but denominated in the SDR basket of currencies would meet the requirements of Article II, Section 9 (a) - the "Philippines formula" provision ~~Article V, Section 12~~ - which permits members to deposit promisory notes in lieu of their own currency. The use of promisory notes would be necessary to effect the exchange of the members' own currency into the SDR basket of currencies without at the same time creating a drawdown of the member's foreign exchange reserves.

liability expressed in a standard other than their own currency might be reduced by permitting member countries to set a temporary national currency limit on the amount of their obligations through an agreement with the Bank that would be an integral part of their subscriptions. That is, they would be permitted to qualify their subscription to the Bank. Under this approach, a member choosing to qualify its subscription would notify the Bank of the total liability that it was accepting in terms of a particular national currency (not necessarily its own) 1/ using exchange rates as of a given date (e.g., the date of agreement on the capital increase). This limit would be allowed to stand for a fixed period of (say) five years, or until a call was made, whichever occurred sooner. The member's liability would ^{remain} fixed at that national currency amount regardless of whether the currency appreciated or depreciated against the SDR.

51. At the time a member notified the Bank that it intended to qualify its GCI subscription, it would also state the actions it would take in connection with a call on the shares being subscribed. These actions might be as follows. If the liability in national currency that the member had accepted came to less than SDR100,000 per share (using the exchange rates at the time of the call), the member would either: (a) surrender to the Bank (immediately prior to the call) a sufficient number of shares to bring its total liability expressed in

1/ See paragraph 57 below.

SDR into line with the amount it had agreed to accept in its chosen currency; or (b) if the member wanted to maintain its shareholding, it could raise (or remove) the limitation set in national currency. Alternatively, if the member's chosen currency had appreciated against the SDR, so that the member's maximum total liability was more than SDR100,000 per share, the member would still pay the (higher) national currency amount (or the proportion of that amount corresponding to the proportion the Bank was calling from members who had not qualified their subscriptions).

52. It may be helpful to illustrate this approach with a simplified example. Suppose that a member country chose to qualify its subscription in terms of the US dollar and the exchange rates on the given date were such that 1SDR = \$1.33. The member would notify the Bank that its maximum total liability would be \$133,000 times the number of shares subscribed. The following tables illustrate the nature of adjustment required in the event of a call, assuming that a member's maximum total liability were less than SDR100,000 per share subscribed.

Adjustment of Qualified Subscriptions
Required in the Event of a Call

	<u>No. of Shares Subscribed</u>	<u>Obligation Per Share</u>		<u>Maximum Total Obligation</u>
		<u>SDR</u>	<u>US\$</u>	<u>US\$</u>
Position at the time of Subscription (SDR = US\$1.33)	50,000	100,000	133,000	6,650,000

Handwritten notes:
 When...
 the 5%...
 temporary...
 when...
 why not...
 discuss the...
 limit...
 in national...
 currency...
 the...
 bank...
 etc...
 could the...
 US...
 in...
 to reduce...
 shares...
 legislation?

If exchange rates at the time of a call had changed in such a way that 1SDR = US\$1.48, the maximum total obligation would be \$6,650,000. ^{nonetheless limited to} Since each share carries an obligation of SDR100,000 = US\$148,000, the number of shares consistent with the maximum total liability if \$6,650,000/\$148,000, or 44,932 shares. In this instance, therefore, either the limit on total liability would be raised, or waived, or the member would surrender 5,068 shares, as shown below:

	<u>No. of Shares Subscribed</u>	<u>Obligation Per Share</u>		<u>Maximum Total Obligation US\$</u>
		<u>SDR</u>	<u>US\$</u>	
Position after Repurchase of Shares	44,932	100,000	148,000	6,650,000

53. Reconsideration of these qualifications on members' GCI subscriptions would take place periodically (member governments might wish to establish some minimum period of, say, five years). These reviews would be expected to result in an agreed realignment of members' relative capital subscriptions. Countries which had qualified their subscriptions to the GCI would reestablish an unqualified GCI subscription within the context of a subsequent realignment of share-holdings. They could ^{do} this by attaining their new percentage of subscribed capital (i.e., the share they had negotiated) in such a way as to establish a maximum accepted total liability equivalent to SDR100,000 per share for all shares subscribed (i.e.,

*what
basis for
an
agreed*

both the GCI and any new share allocations that were agreed in the negotiation). This might be accomplished in a variety of ways, such as surrender of GCI shares to the Bank or an increase in the total liability the member country agrees to accept. A country whose maximum total liability had appreciated (because the component currency used to determine the limit on the member's liability had appreciated vis-a-vis the SDR) might be permitted (with the Bank's approval) to reduce its contingent liability to its new SDR value by accepting the SDR as the standard of value for its GCI subscription without qualification.

54. An important issue with respect to such a modification to the "SDR only" option is whether or not members should be forced to make an adjustment in their qualified liabilities or shareholdings in the event a negotiated realignment of relative capital subscription cannot be achieved. If it were considered necessary or desirable to maintain a close correspondence between GCI votes and obligations even if subsequent capital increases could not be agreed, then it might be appropriate to establish an automatic "fall-back" mechanism. Such a mechanism--which would affect only those countries whose qualified obligation had depreciated in relation to the SDR by more than, e.g., 10%--might require that members either raise or remove entirely the qualification of their liability in terms of the component currency or surrender sufficient shares to the Bank to reestablish an obligation equal to SDR100,000 per share. That is, an adjustment in liability or

shareholding would be made in the same fashion as would take place in the event of a call. This adjustment might also take place for any member that failed to implement an agreed realignment within a reasonable period of time.

55. It would also be possible not to include any such "fall back" mechanism in the qualified subscription agreement between the member and the Bank. Thus, qualification with respect to total liability on any member's GCI subscription would remain in effect unless: (a) the member voluntarily decided to raise the limit or waive the qualification altogether; or (b) a call were made. On the other hand a member whose accepted liability amounted to more than SDR100,000 per share might still be permitted to remove its qualification (with the Bank) and accept the SDR as its standard of value without qualification.

56. If no automatic adjustment were included in the agreement to qualify a members' subscription, i.e., if the member could never be forced to make an adjustment, except in the event of a call, the practical effect of the "SDR only" option would be very similar to the multiple currency option, at least for those countries whose national currencies are acceptable to the Bank for purposes of qualified callable capital obligations (see below). This might make the "SDR only" option more acceptable to certain members that have the greatest difficulty accepting an SDR-denominated contingent liability.

However, the more the qualification agreement becomes like the multiple currency option, the more likely it is to raise the same legal issues. Thus, it could also prove necessary to amend the Articles in order to implement a qualified subscription scheme, if there is no automatic adjustment of members' subscriptions to their SDR value from time to time.

57. Because of the possibility of major depreciation of some members' currencies over a period of five years, it might be appropriate to restrict the number of currencies in which members could qualify their subscriptions. One way of restricting the range of currencies usable for this purpose would be to simply give members the right to make an unqualified subscription in SDR or to limit their obligation in terms of one of the component currencies of the SDR. Other groupings of currencies are, of course, possible, but the SDR basket currencies have the advantage of being directly tied to the value of the SDR and are not, therefore, likely to permit a member's qualified subscription to get too far out of line with the SDR value. In addition, the SDR basket includes the currencies (e.g., the franc or the dollar) against which many members maintain their own national currencies. Such a restriction would, of course, make the qualified SDR option event more like the multiple currency approach.

Modifications to the Multiple Currency Option

58. Member countries other than the G-5 would face the same

inconveniences with respect to the paid-in portion of their capital subscription under the multiple currency option as under the "SDR only" approach. These inconveniences could be dealt with in exactly the same way, i.e., by flexibility in settlement of MOV obligations and/or application of the "Philippines formula". However, the currency to be substituted for the member's own currency under the multiple currency approach would be whatever unit the member chose as its subscription currency, i.e. the SDR basket or one of the component currencies of the SDR.

59. Members subscribing in one of the SDR currencies would automatically fix a (permanent) limit to their callable capital obligation in terms of that currency. Non G-5 countries could be given additional flexibility by permitting subscriptions to be temporarily limited or qualified in terms of a currency other than the one chosen as a standard of value, with an adjustment mechanism in the event of a call similar to that described above. Adjustment would be in terms of the chosen standard of value, not necessarily the SDR.

60. The problem of divergence in relative voting power and relative obligations due to exchange rate movements could also be dealt with by periodic adjustments in liabilities or shareholdings. Such an adjustment mechanism might operate with respect to GCI subscriptions as follows. At the time of future reviews of capital subscriptions, the value of members' GCI subscriptions would be stated

in terms of SDR, using exchange rates prevailing on the date of the review. Other indicators of relative economic and financial standing would also be considered, and negotiations would take place on realignments of capital subscriptions to reflect exchange rate changes as well as other factors. It would not be necessary for either legal or economic reasons to take account of the full amount of exchange rate changes, i.e. to bring the SDR value of all members' GCI subscriptions back to precisely SDR100,000. For example, a range of plus or minus 5-10% of that amount might be sufficient.

61. However, the mechanism for accomplishing this adjustment would be less likely to involve surrender of GCI shares by members' whose standard of value had depreciated or increases in their GCI liabilities. Even if each of the five SDR currency countries agreed to make such adjustments, it would be difficult to make that same agreement binding on all members that have chosen one of the respective SDR currencies as their standard of value. Moreover, there would be no way of forcing members to adjust the component currency value of their shares, since their subscription would be legally denominated in the component currency, not the SDR.

62. Negotiated adjustments in relative shareholdings could also be achieved through the issuance of new shares at a lower subscription price, similar to the way in which voting power adjustments are brought about in IDA. Under this approach the country or countries whose

standard of value had depreciated the most against the SDR (the so-called "pivot" country in IDA) would receive the fewest (or no) shares and the other countries would receive selective amounts of shares designed to reduce their average obligation per share to that of the lowest group of countries and raise their voting power correspondingly. A drawback to this technique is that it results in a progressive reduction in the price per share and increasingly large share issues for any given increase in subscriptions.

Section 6: Existing Capital Subscriptions

63. The range of possible solutions to the valuation of existing capital subscriptions is much more limited than for future subscriptions. First of all, abolition of a common standard altogether with respect to existing capital would entail legal and financial problems because of the Bank's creditors. Similarly, there would be problems in implementing the multiple currency option retrospectively, since the existing shares were all subscribed at an issue price of 100,000 1944 gold dollars.

64. The "SDR only" option, on the other hand, could be implemented for existing subscriptions in just the same way as it would apply to future capital increases (including the GCI). Indeed, the General Counsel's 1976 opinion dealt primarily with the question of what members should understand by the term "US dollars of the weight and fineness in effect July 1, 1944" as it applies to their existing capital. Adoption of the SDR as the Bank's standard of value would have the effect of reexpressing members' obligations with respect to shares already subscribed in terms of SDR rather than 1944 dollars.

65. The Bank and its shareholders may have some flexibility with respect to existing shares. As noted above, it would be possible for the Directors to decide that the successor to the 1944 gold dollar should be 1.20635 current dollars, i.e., the US dollar's last official par value. Since there is room for disagreement as to which of these

two units should be substituted for the 1944 dollar, it is conceivable that members could be given a choice of one or the other with respect to existing subscriptions.

66. However, this possibility raises ~~serious~~ legal issues that need thorough study. This option would also have adverse implications for the Bank's finances if the US dollar proves to be less strong over time than the SDR. If the current dollar had been adopted as the standard of value on existing subscriptions on this basis rather than the SDR, the Bank's capital subscriptions and commitment authority would have been \$3.4 billion (8.5%) less at the end of 1980.

Section 7: Summary and Conclusions

67. A strong common standard of value helps the Bank and its shareholders by preserving commitment authority and financial strength and by maintaining a close relationship between members' rights and their obligations. Retaining a single common standard of value will, however, complicate the process of subscription, compared to a system in which each member subscribes in its own currency. And, the counterpart of the stronger financial base for the Bank is the need for members with depreciating currencies to contribute additional resources.

68. Substitution of the SDR for the 1944 gold dollar would tend to maximize both the benefits and the costs of a standard of value. Commitment authority would be maintained in terms of a strong standard and the correspondence between votes and subscriptions would be maintained. A multiple currency standard based on the SDR currencies would introduce a degree of flexibility for some members and substantial advantages for the five SDR currency countries, as compared to the "SDR only" standard. The multiple currency standard would correspondingly weaken the link between votes and obligations over time.

69. Adjustment mechanisms could be included in the SDR system to help alleviate the administrative and legislative requirements for members. In the multiple currency option, disparities in relative

burdens per share might be taken into account in negotiated realignments of shareholdings and voting power, but would be difficult to remove. For some members--particularly the five SDR currency countries--the adjustment mechanisms in the SDR approach could provide many of the benefits of the multiple currency option.

70. The Bank's shareholder governments have a variety of national legislative and administrative arrangements for handling capital subscriptions to the Bank, and the suggestions in this memorandum are likely to be more acceptable to some members than others. We believe that a practical next step in resolving the capital valuation issue would be for the Directors to indicate which (if any) of the options discussed in this memorandum they would prefer to be adopted. These preferences might include not only one of the basic options but also the nature and extent of modifications to that option that might be most attractive to the members of their constituencies.

THE WORLD BANK

Office of the President

Suggest to Moran & Joe prep 2nd
the late Paper by David Book
(by 1/15) see turned down pages
←
Moran & Joe agreed to do it

The World Bank

December 19, 1980

Mr. McNamara:

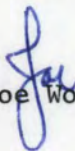
Please find attached the following materials on maintenance of value:

Proposals

- 12/19
- #1 Bergsten's proposal telexed to the G-6 a few days ago. It is due to be discussed early next week.
 - #2 A French proposal which was also circulated to the G-6 late last month.
 - #3 Our proposals, which we have given to the G-6 and which triggered a strong negative reaction from Bergsten.
 - #4 The Joint Proposal, prepared some months ago by the Europeans. We understand the Germans and the Japanese still like this one the best.

Commentary

- #5 Two notes by David Bock which summarize some of the key issues.
- #6 A memorandum by Lester Nurick which goes over similar ground but from a slightly different perspective.


Joe Wood

Attachments

#1

The World Bank

1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.

718/3/1



December 15, 1980

With the compliments of
Mr. Colbert I. King
U.S. Executive Director
477-2776

Mr. Robert S. McNamara

A copy of the attached paper was telexed to the capitals of Canada, France, Germany, Japan and the U.K. I understand the meeting has now been set for December 22.

Colbert I. King

Attachment

12/15

VALUATION OF IBRD CAPITAL SUBSCRIPTIONS

FOR THE GENERAL CAPITAL INCREASE

IN JUNE 1980, AGREEMENT WAS REACHED ON ARTICLES OF AGREEMENT FOR THE COMMON FUND FOR COMMODITIES. IN REFLECTION OF THE DEVELOPMENT OF A MULTI-CURRENCY SYSTEM WHICH, IN TURN, HAS BEEN REFLECTED IN THE SHIFT IN THE VALUATION OF THE SDR TO A FIVE-CURRENCY BASKET, OBLIGATIONS OF EACH MEMBER WERE VALUED, AT THE OPTION OF THE MEMBER, IN ONE OF THE FIVE FREELY USABLE CURRENCIES OR THE SDR. THE PROPOSAL ON THE UNIT OF VALUE AND MAINTENANCE OF VALUE ISSUES WHICH IS PUT FORWARD IN THIS PAPER APPLIES THE COMMON FUND FORMULA TO THE GENERAL CAPITAL INCREASE OF THE IBRD WITH MODIFICATIONS SUITABLE TO THE DIFFERING CHARACTER AND CHARTER OF THE IBRD AS WELL AS TO THE TERMS OF THE GENERAL CAPITAL INCREASE THAT WAS APPROVED ON JANUARY 4, 1980. THE PROPOSAL IS IN MANY ESSENTIAL RESPECTS SIMILAR TO THE PROPOSAL CIRCULATED BY FRANCE LAST MONTH.

SUBSCRIPTION PRICE, UNIT OF OBLIGATION AND CURRENCY OF PAYMENT

THE SUBSCRIPTION PRICE PER SHARE WOULD BE EXPRESSED IN SDR AND IN THE FIVE FREELY USABLE CURRENCIES. EACH MEMBER COULD ELECT TO HAVE ITS OBLIGATIONS UNDER THE GCI DENOMINATED IN SDR OR IN ONE OF THOSE FIVE CURRENCIES. THE ELECTION OF THE UNIT OF OBLIGATION WOULD BE MADE AT THE TIME OF SUBSCRIPTION; IF THE SUBSCRIPTION TO THE GCI WERE MADE IN INSTALLMENTS, THE ELECTION FOR ALL GCI SHARES WOULD BE MADE AT THE TIME OF SUBSCRIPTION TO THE FIRST INSTALLMENT.

THE PURCHASE PRICE PER SHARE WOULD BE SDR 91,315.4. THE PURCHASE PRICE IN THE FIVE FREELY USABLE CURRENCIES, WHICH WOULD REMAIN UNCHANGED, WOULD BE DETERMINED BY THE RELATIONSHIP OF THE SDR TO THE PARTICULAR CURRENCY ON JANUARY 4, 1980, THE DATE OF APPROVAL OF THE GENERAL CAPITAL INCREASE. THE PURCHASE PRICE PER SHARE WOULD BE:

- U.S. \$120,635
- 28,650,846 YEN.
- 485,013 FRENCH FRANCS
- 206,949 DM AND
- 53,987 POUNDS STERLING.

(SEE ANNEX FOR DETAILS ON THESE CALCULATIONS.)

AN ISSUE PRICE OF SDR 100,000 PER SHARE WOULD RESULT IN AN INCREASE IN CAPITAL IN EXCESS OF \$40 BILLION, WHICH IS PROHIBITED BY THE GCI RESOLUTION. THUS, A VALUATION OF EACH SHARE AT SDR 100,000 WOULD REQUIRE A SCALING DOWN BOTH OF THE SHARES ALLOCATED AMONG MEMBERS AND OF THE TOTAL NUMBER OF SHARES WHICH HAVE BEEN SET ASIDE FOR SPECIAL INCREASES (SOME OF WHICH HAVE ALREADY BEEN PURCHASED BY ZIMBABWE AND THE PRC). VALUING EACH SHARE AT SDR 91,315.4 WOULD MAKE IT UNNECESSARY TO ESTABLISH A COMPLICATED SCALING DOWN MECHANISM.

[AS PROVIDED IN THE ARTICLES OF AGREEMENT,] ^{7.5}~~10~~ PERCENT OF THE PAID-IN PORTION WOULD BE PAYABLE IN DOLLARS AND NINETY PERCENT IN THE MEMBER'S NATIONAL CURRENCY. THE AMOUNT IN DOLLARS WOULD BE CALCULATED BY THE EXCHANGE RATE OF THE DOLLAR TO THE UNIT OF OBLIGATION (SDR OR ONE OF THE FIVE CURRENCIES)

AND THE AMOUNT IN THE NATIONAL CURRENCY WOULD BE CALCULATED ON THE BASIS OF THE EXCHANGE RATE BETWEEN THE CURRENCY OF PAYMENT AND THE UNIT OF OBLIGATION. PAYMENT WOULD BE MADE AT THE TIME OF SUBSCRIPTION, AND EXCHANGE RATES AT THAT TIME WOULD BE DETERMINATIVE.

MAINTENANCE OF VALUE

AS PROVIDED IN THE IBRD CHARTER, MAINTENANCE OF VALUE WOULD NOT BE APPLICABLE TO THE 10 PERCENT PORTION OF THE PAID-IN CAPITAL WHICH WOULD BE PAYABLE IN DOLLARS. THE 90 PERCENT PORTION, HOWEVER, WOULD BE SUBJECT TO MAINTENANCE OF VALUE IN TERMS OF THE UNIT OF OBLIGATION THAT HAD BEEN SELECTED. THOSE OF THE FIVE MAJOR COUNTRIES THAT HAD SELECTED THEIR OWN CURRENCY AS THE UNIT OF OBLIGATION WOULD NOT BE SUBJECT TO MAINTENANCE OF VALUE ON THE NATIONAL CURRENCY PORTION OF THE SUBSCRIPTION.

THIS WOULD ALSO BE THE CASE WITH REGARD TO CALLABLE CAPITAL. THE EXTENT OF THE OBLIGATION IN THEIR NATIONAL CURRENCY WOULD BE FIXED AS OF THE TIME OF SUBSCRIPTION FOR THOSE OF THE FIVE MAJOR COUNTRIES WHICH HAD CHOSEN TO DENOMINATE THEIR OBLIGATIONS IN THEIR OWN CURRENCY.

FINANCIAL IMPLICATIONS

THE USE OF THE ABOVE FORMULA IS CONSISTENT WITH CURRENT INTERNATIONAL MONETARY PRACTICE IN WHICH ALL FIVE CURRENCIES, ALONG WITH THE SDR, CONSTITUTE PRIMARY RESERVE ASSETS. USE OF THIS FORMULA WOULD BE PARTICULARLY APPROPRIATE IN VIEW OF THE RECENT CHANGE IN THE VALUATION OF THE SDR TO THESE FIVE CURRENCIES.

THIS FORMULA SHOULD HAVE LITTLE, IF ANY, EFFECT ON THE WORLD BANK'S CAPITAL VALUE EXPRESSED IN SDRS, AS THE CROSS-CURRENCY EXCHANGE RATE VARIATIONS OF THESE FIVE CURRENCIES WILL LARGELY, IF NOT COMPLETELY, TEND TO CANCEL EACH OTHER OUT. ANY VARIATIONS IN THE SDR VALUE OF THE BANK'S GCI CAPITAL, WHILE MODEST, COULD JUST AS EASILY BE POSITIVE AS NEGATIVE. FOR EXAMPLE, ON THE ASSUMPTION THAT EACH OF THE FIVE MAJOR COUNTRIES HAD CHOSEN ITS OWN CURRENCY IN TERMS OF WHICH TO VALUE ITS SHARES AND THE OTHER COUNTRIES HAD SELECTED THE SDR, THE TOTAL SDR VALUE OF THE BANK'S GCI CAPITAL WOULD HAVE APPRECIATED 1.8 PERCENT BETWEEN JANUARY 4, 1980 AND DECEMBER 10 OF THIS YEAR. (IF THE OTHER COUNTRIES HAD ALL CHOSEN THE U.S. DOLLAR TO VALUE THEIR SHARES, THE SDR APPRECIATION WOULD HAVE BEEN MUCH LARGER -- 4.4 PERCENT).

THIS EXPERIENCE POINTS TO THE RISKS INDIVIDUAL COUNTRIES WOULD RUN BY TRYING TO MINIMIZE THEIR EXPECTED OBLIGATIONS THROUGH THEIR CHOICE AMONG THE FIVE FREELY USABLE CURRENCIES TO VALUE THEIR SHARES. IN VIEW OF THIS FACT, COUNTRIES CAN BE EXPECTED TO CHOOSE AMONG THE FIVE CURRENCIES LARGELY IN LIGHT OF THE COMPOSITION OF THEIR OWN RESERVES AND NOT IN TERMS OF GUESSES OF FUTURE EXCHANGE RATE MOVEMENTS. IT SHOULD BE NOTED THAT COUNTRIES OTHER THAN THE ISSUERS OF THESE CURRENCIES WOULD BE REQUIRED TO MAINTAIN THE VALUE OF THEIR GCI SHARES AGAINST EITHER THE SDR OR ONE OF THE FIVE FREELY USABLE CURRENCIES, THUS PROTECTING THE BANK AGAINST EROSION OF THE VALUE OF ITS CAPITAL DUE TO DEPRECIATION OF SUCH OTHER CURRENCIES.

REVIEW AND ADJUSTMENT MECHANISM

IT HAS BEEN ARGUED THAT, EVEN THOUGH THE FIVE CURRENCY FORMULA WOULD HAVE LITTLE OR NO ADVERSE EFFECT ON THE BANK'S CAPITAL, A SINGLE STANDARD OF VALUE IS NECESSARY TO PRESERVE A CONSTANT RELATIONSHIP BETWEEN FINANCIAL OBLIGATIONS AND VOTING RIGHTS. HOWEVER, THERE ARE MANY FACTORS IN ADDITION TO EXCHANGE RATE CHANGES THAT SHOULD AFFECT THE RELATIVE VOTING RIGHTS OF MEMBERS IN THE BANK -- AS HAS ALWAYS BEEN THE CASE IN THE PAST. ALTERING VOTING RIGHTS BASED SOLELY ON EXCHANGE RATE CHANGES LEADS TO ANOMALOUS CONCLUSIONS, SUCH AS AUTOMATIC LOSS OF VOTING RIGHTS FOR A COUNTRY WHOSE CURRENCY MAY HAVE DEPRECIATED AS A RESULT OF A WORSENERD CURRENT ACCOUNT DEFICIT FOLLOWING A MORE RAPID RATE OF ECONOMIC GROWTH -- WHICH HELPED STIMULATE THE WORLD ECONOMY AND THUS THE ECONOMIES OF DEVELOPING COUNTRIES WHICH THE BANK EXISTS TO SUPPORT.

FURTHERMORE, AT LEAST SOME LEGISLATURES WOULD REGARD AUTOMATIC ALTERATIONS OF VOTING POWER RESULTING FROM EXCHANGE RATE CHANGES AS FUNCTIONALLY EQUIVALENT TO CHANGES IN FINANCIAL OBLIGATIONS, I.E., MAINTENANCE OF VALUE. THEREFORE, ADOPTION OF SUCH A PRINCIPLE, LIKE MAINTENANCE OF VALUE ITSELF, COULD SEVERELY JEOPARDIZE SUPPORT FOR PARTICIPATION IN THE BANK.

HOWEVER, IT IS QUITE PROPER TO TAKE INTO ACCOUNT CHANGES IN EXCHANGE RATES IN DETERMINING SHARES IN FUTURE CAPITAL SUBSCRIPTIONS. THIS COULD BE DONE BY A GENERAL REVIEW OF CAPITAL SUBSCRIPTIONS WHICH WOULD TAKE PLACE IN THE CONTEXT OF A GCI OR EVERY FIVE YEARS, WHICHEVER CAME FIRST. SUCH REVIEWS COULD RESULT IN AN AGREED REALIGNMENT OF MEMBERS' RELATIVE

CAPITAL SUBSCRIPTIONS. SUCH REALIGNMENT WOULD BE BASED ON RELATIVE EXCHANGE RATE CHANGES AS WELL AS SUCH OTHER FACTORS AS CHANGES IN WORLD TRADE SHARES, BALANCE OF PAYMENTS AND INTERNATIONAL RESERVE POSITIONS, AND RELATIVE RATES OF ECONOMIC GROWTH AS WELL AS SUPPORT FOR THE WORLD BANK GROUP. IT COULD BE EXPECTED THAT RELATIVE CHANGES IN THESE FACTORS WOULD BE REFLECTED IN CHANGES IN RELATIVE SHARES IN FUTURE CAPITAL SUBSCRIPTIONS.

ANNEX

CALCULATION OF PURCHASE PRICES OF WORLD BANK SHARES

THE PURCHASE PRICE OF SDR 91,315.4 PER SHARE IS CALCULATED BY DIVIDING THE LAST PAR VALUE OF THE 1944 GOLD DOLLAR (\$1.20635) BY THE VALUE OF THE SDR IN TERMS OF U.S. DOLLARS AS OF JANUARY 4, 1980 (\$1.32108) AND MULTIPLYING THE RESULT BY SDR 100,000. THIS PROCEDURE ENSURES THAT THE TOTAL NUMBER OF ISSUED SHARES, 331,500, IS CONSISTENT WITH THE \$40 BILLION LIMIT ON THE GCI SET OUT IN THE GCI RESOLUTION.

THE CONVERSION OF THE SDR 91,315.4 PURCHASE PRICE INTO PURCHASING PRICES IN EACH OF THE FIVE FREELY USABLE CURRENCIES IS DONE BY USING THE VALUE OF THE SDR IN TERMS OF EACH OF THOSE CURRENCIES AS OF JANUARY 4, 1980.

#2
OFFICE MEMORANDUM

TO: DATE: November 19, 1980
FROM: Paul MENTRE de LOYE, Executive Director for France 7/1
SUBJECT: Maintenance of Value

80-193

Please find hereenclosed copy of a telex I am forwarding to you on behalf of my Authorities.

This documents includes a tentative solution for the Maintenance of Value of Contributions to the World Bank mentionned by Mr. JURGENSEN at the G VI discussions in Washington.

It is not, at this stage, a French proposal, but only a detailed presentation of a type of compromise solution.

cc :- Mr. Eberhard KURTH
- Mr. Colbert KING
- Mr. Seiji MORIOKA
- Mr. Earl DRAKE
- Mr. John ANSON
- Mr. Joseph WOOD
(Financial Policy and Analysis Dept)
- Mr Scott (Legal Department)

IBRD LANGUAGE SERVICES DIVISION	
CONTROL No. E-639/81	DATE: November 20, 1980
ORIGINAL LANGUAGE: French (France)	
DEPT. EDS	TRANSLATOR: ENMcM:hb

Telex of November 13, 1980, No. 80/1494 from Trésor, Paris
to U.S. Treasury, Washington

...

"Use of the Common Fund for Commodities formula as a means of implementing the joint proposals submitted by Germany, France, Japan and the United Kingdom.

1. In October 1979 in Belgrade, these four countries jointly submitted a compromise proposal on the issue of the value of the World Bank's capital. Since then, in the course of negotiations on the Common Fund for Commodities, the same problem has been discussed and has given rise to a novel solution based on the use of the five major currencies alongside the SDR. Such an approach is not necessarily at variance with the ideas developed in the four countries' joint proposal and might even facilitate its application. The purpose of the proposals submitted below is to show how these two approaches might be combined.

2. Unit of account, unit of commitment, currency of payment

-- The unit of account for the Bank would be the SDR.

-- At the time of every capital increase, each State would elect to commit itself to a contribution amount denominated either in SDRs or in one of the five major currencies (the unit so selected will hereinafter be termed the "unit of commitment").

-- Contributions would continue to be paid, as required under the Articles of Agreement, essentially in national currencies. It would, however, be necessary to substitute the five major currencies for the dollar in regard to that portion (10% in general) statutorily payable in gold or in dollars.

3. Modalities of payment of called capital and callable capital

The amount in national currency of each payment would be calculated on the basis of the exchange rate on the date of payment between the currency of

the member country and the unit of commitment selected by such member (SDR or one of the five currencies).

For the called capital up to the moment of payment, and for the callable capital, there would thus be maintenance of value in relation to the unit of commitment selected. Those of the five major countries that had committed themselves in their own currency would not, however, be affected and would know in advance the precise amount of their contributions, subject to the provisions of items 5 through 8 below.

4. Maintenance of value of called capital after payment

After payment, each member State would be required to maintain the value, expressed in the selected unit of commitment, of the contribution made in national currency.

Those of the five major countries that have adopted their currency as the unit of commitment would de facto be exempted from this obligation--for them the obligation to maintain the value of their contributions would be reflected in the rules set forth in detail in items 5 through 8 below.

It would, however, be possible to exempt those states that authorize the Bank to convert their own contributions into other currencies from the obligation to maintain the value of their contributions subsequent to payment. The Bank could then put such contributions in the SDR basket, applying the so-called "Philippine" formula.

5. Such a system would protect neither the Bank nor its members against two adverse effects of fluctuations in the five major currencies:

-- Loss of value, expressed in SDRs, of the capital if the depreciating currencies are more strongly represented in the Bank's capital than in the SDR basket.

-- The distortions that can appear between voting rights and real contributions.

The risk of loss of value of capital is made all the more real by the considerable likelihood that many countries will elect to express their commitments in those of the five currencies that seem most likely to depreciate relative to the SDR.

There is thus need for a review and adjustment procedure specifically aimed at remedying difficulties created by fluctuations in the five currencies.

As the four countries' joint memorandum proposed, this procedure would be implemented periodically--at the time of each capital increase or at least every three years. There would be two aspects to these adjustments, depending on whether currencies had appreciated or depreciated.

6. Adjustments connected with the appreciation of a currency

For those currencies that have appreciated by more than 3% relative to the SDR, the Bank would proceed, vis-à-vis those States that have selected such currencies as their units of commitment, to adjust their contributions with a view to offsetting the increase in the value of such contributions in terms of SDRs:

-- In regard to called capital, the Bank would reimburse the excess in relation to the initial value in SDRs.

-- In regard to callable capital, the commitments of those States expressed in the currency selected as unit of commitment would be reduced in such a way that their value in SDRs will correspond to their value at the time of the preceding review.

As a net result of this adjustment, the countries that have entered into a commitment in a currency that appreciates are not penalized in relation to those that selected the SDR.

7. Adjustments connected with the depreciation of a currency

If one of the five currencies has depreciated by more than 3% relative to the SDR, the States that have selected it as their unit of commitment would have the choice of adjusting their actual contribution or adjusting their relative voting power.

In concrete terms, this would be effected by means of an increase in capital involving both paid shares and bonus shares, along the lines of the across-the-board distribution of 250 shares per member State resolved as an adjunct to the general increase in the Bank's capital. Each country would be afforded the opportunity to subscribe to a number of additional shares representing a uniform percentage of the number of shares already held. However, the breakdown between bonus shares and paid shares would vary.

-- Those countries that had selected as their unit of commitment the currency that had depreciated most would not receive any bonus shares. The percentage increase in capital would thus correspond to the depreciation of that currency relative to the SDR.

-- Those countries that had committed themselves in terms of SDRs or in currencies that had appreciated relative to the SDR would receive only bonus shares.

Those countries whose unit of commitment was in an intermediate position would be offered a mix of the two types of shares.

Such an increase in capital would appear useful as an adjustment procedure for two reasons:

-- First, it would avoid the legal problems connected with suspension of voting rights;

-- Secondly, it can easily be integrated into larger-scale capital increases during which the review and adjustment procedure is implemented.

8. The two types of adjustment (connected with depreciation or with appreciation of a currency) would be combined as follows:

-- Countries whose unit of commitment has appreciated by more than 3% relative to the SDR will obtain:

- Reimbursement of part of the called capital;
- Adjustment in the amount of their commitment in respect of callable capital;
- Additional voting rights at no cost offsetting the benefits obtained by those whose unit of commitment has depreciated.

-- Those countries whose unit of commitment is the SDR or has behaved like the SDR (within the 3% margins) will not see any change in their contributions but will receive bonus voting rights corresponding to the depreciation-related adjustment, if any.

-- Those countries whose unit of commitment has depreciated by more than 3% relative to the SDR will have to elect between an increase in their actual contribution by means of an increase in capital, at least a part of which will be in the form of shares to be paid for by them, or alternatively an erosion in their relative voting power."

#3

December 5, 1980

The attached note describes two options for dealing with the problem of valuation of IBRD capital. These options are being put forward in an effort to promote an early agreement in principle on how to settle this long-standing problem.

The note describes the options but does not comment on their respective merits. The main difference between them is that Option #1 requires that a periodic adjustment take place to bring countries' subscription votes into line with their liabilities to the Bank (i.e. their unqualified commitment to supply capital in the event of a call), whereas Option #2 provides for such a periodic adjustment but does not require it. If periodic adjustments through negotiation were to succeed voluntarily, there would be no practical difference between the two options. Where they differ is in what happens if negotiations do not succeed or members do not implement the negotiated adjustments. In that case Option #1 would still result in the IBRD capital being maintained in value (measured in terms of SDRs), whereas Option #2 would not. The value of IBRD capital in Option #2 could be higher or lower over time, depending on what happens to the exchange rates of the currencies which will make up the SDR beginning January 1, 1981. It would seem reasonable to expect at least some countries to choose to limit their liability to the Bank in terms of a constituent currency which they believe is likely to depreciate relative to the SDR. If they do so and if they are right, the value of the IBRD capital (measured in SDRs) would erode over time. Movements in value on the order of 10% or more would be quite consistent with past experience. Changes in the value of capital of this magnitude would have a noticeable impact on the IBRD's financial position and on its lending authority under the present Articles.

Another important difference is that Option #1 involves a common standard of value (the SDR) - subject to temporary variations over 5 year periods - whereas Option #2 could - if negotiated re-alignments fail - develop into a multiple standard of value system, in which the SDR and some or all of its constituent currencies are all standards of value. This could result in substantial discrepancies over time between countries' relative subscription votes and their relative liabilities to the IBRD.

Because of these two considerations - possible erosion in the value of capital and possible discrepancies between subscription votes and relative liabilities - it would be desirable that, if Option #2 were adopted, it be restricted in its application both with respect to the currencies that members are permitted to use to express their maximum total liability and with respect to the number of members permitted to limit their liability to an amount expressed in units other than the SDR.

These Options are being put forward on the assumption that either could be adopted by interpretation.

Valuation of IBRD Capital Subscriptions

Outline of Two Possible Solutions 1/

Option 1

The SDR would be adopted as the common standard of value. The subscription price per share would be SDR100,000, but all members would have the option of limiting the amount of their obligations to the Bank through an agreement with the Bank that would be an integral part of their subscriptions.

Members would be encouraged to make their subscriptions in SDR without qualification. If a member nevertheless chooses to qualify its subscription, its notification would state the maximum total liability that the member was accepting in terms of one of the constituent currencies of the SDR, using exchange rates as of a given date (e.g. the date of effectiveness of the GCI). If, for example, the US dollar were chosen and the exchange rates on the given date were such that 1SDR = \$1.33, the maximum total liability would be stated as \$133,000 times the number of shares subscribed. The notification would also state the actions the member would take in connection with a call on the shares being subscribed. These actions would be as follows. If the maximum total liability the member had accepted were less than SDR100,000 per share (using the exchange rates

1/ These proposals refer only to the General Capital Increase. Whether they would be extended to future capital increases could be decided at the time of future increases. The treatment of existing capital subscriptions would be considered as soon as agreement is reached on these proposals.

at the time of the call), the member would (immediately prior to the call) sell to the Bank a sufficient number of shares to reduce its SDR liability to the total it had agreed to accept in its chosen constituent currency. Alternatively, any member whose SDR obligation exceeded the limitation previously established in terms of one of the SDR currencies and who wanted to maintain its shareholding could raise (or remove) the limitation. If the member's currency had appreciated against the SDR, so that the member's maximum total liability were more than SDR100,000 per share, the member would pay the higher amount (or the proportion of that higher amount corresponding to the proportion the Bank was calling from members who had not qualified their subscriptions).

The following tables illustrate the nature of adjustment required in the event of a call, assuming that a member's maximum total liability were less than SDR100,000 per share subscribed.

Adjustment of Qualified Subscriptions
Required in the Event of a Call

	<u>No. of Shares Subscribed</u>	<u>Obligation Per Share SDR</u>	<u>Per Share US\$</u>	<u>Maximum Total Obligation US\$</u>
Position at the time of Subscription (SDR=US\$1.33)	50,000	100,000	133,000	6,650,000

Assume that exchange rates at the time of a call had changed in such a way that 1 SDR = US\$ 1.48. Since the maximum total obligation is

\$6,650,000 and since each share carries an obligation of SDR100,000 = US\$148,000, the number of shares consistent with the maximum total liability is $\$6,650,000/\$148,000 = 44,932$ shares 1/. Therefore, either the limit on total liability would be raised, or waived, or the member would surrender 5,068 shares.

	<u>No. of Shares Subscribed</u>	<u>Obligation Per Share SDR</u>	<u>Per US\$</u>	<u>Maximum Total Obligation US\$</u>
Position after repurchase of shares	44,932 <u>1/</u>	100,000	148,000	6,650,000

Maintenance of value would apply on the paid-in portion of the shares being subscribed in terms of the SDR, but members could effectively be relieved of the need to make MOV payments (or to receive such payments) in one of two ways:

(a) any member that released the paid-in portion of its subscription and agreed to exchange that portion for SDRs or the currencies of the SDR basket, would be relieved of MOV obligations (this is the "Philippine formula" approach.)

(b) any member that qualified its subscription would not be

1/ Figures subject to minor adjustment for that small portion of subscriptions paid in gold or current US dollars.

required to settle its MOV obligation except in relation to changes in the exchange rate between its national currency and the currency in which it limited its maximum total liability.

Every five years there would be a review of member countries' subscriptions to the Bank as part of a general review of capital subscriptions recommended in the recent memorandum on Criteria for Selective Capital Increases (R80-326 dated November 18, 1980, para.25). These reviews would be expected to result in an agreed realignment of members' relative capital subscriptions. The criteria on which the realignment was based would not be limited to the impact of exchange rate changes, but rather would be based on broader economic and financial measures of the sort used in the IMF's calculation of calculated quotas, as well as on measures of support for the Bank Group.

Countries which had qualified their subscription to the GCI would be expected to attain their new percentage of subscribed capital (i.e. the share they had negotiated) in such a way as to establish a maximum accepted total liability equivalent to SDR100,000 per share for all shares subscribed (i.e., both the GCI and any new share allocations that were agreed in the negotiation). This might be accomplished in a variety of ways such as sale of GCI shares to the Bank or an increase in the total liability the member country agrees

to accept. A country whose maximum total liability had appreciated (because the component currency used to determine the limit on the member's liability had appreciated vis-a-vis the SDR) could, with the Bank's approval, reduce its contingent liability by permanently accepting the SDR as the standard of value without qualification.

In the event a negotiated agreement or realignment of relative capital subscriptions were not reached, or a member failed to implement that agreement within a reasonable period of time, then a "fall-back" mechanism would come into operation. This mechanism - which would affect only those countries whose qualified obligation had depreciated in relation to the SDR by more than []% - would require that members either raise (or remove entirely) the qualification of their liability in terms of the component currency or sell sufficient shares to the Bank to re-establish an obligation equal to SDR100,000 per share (in the same fashion as would take place in the event of a call).

Option 2

Option 2 is very similar to Option 1. The subscription price per share would continue to be SDR100,000, and members would be given the same choices with respect to MOV on paid-in capital. Members would also be permitted to qualify the amount of their total liability to the Bank in terms of one of the SDR currencies. In the event of a call, the same adjustment mechanism would apply to the shareholdings

of members whose qualified liability had depreciated against the SDR and members with qualified liabilities would also be expected to pay a higher amount if their qualified liability had appreciated.

At the time of five-year reviews of capital subscriptions, members would be expected, as in Option 1, to re-establish an accepted liability of SDR100,000 per share (for all shares subscribed) within the context of broad negotiation on realignments of capital subscriptions. However, in the event a negotiated realignment of relative capital subscriptions were not reached, or members did not implement the negotiated changes the automatic adjustment provided in Option 1 would not take place. Hence, the qualification with respect to total liability on any member's GCI subscription would remain in effect unless the member voluntarily decided to raise the limit or waive the qualification altogether. The waiver of the qualification for a member whose accepted liability amounted to more than SDR100,000 per share would have to be permanent and by agreement with the Bank.

JOINT PROPOSAL BY FRANCE, GERMANY, JAPAN, AND THE
UNITED KINGDOM ON THE VALUATION OF THE BANK'S CAPITAL

1. The 1944 Gold Dollar shall be replaced by the SDR as the standard of value under the Bank's Articles.
2. Members who prefer to avoid MoV obligations in relation to paid-in capital in the period following encashment shall have the option of authorising the Bank to convert the paid-in portion of capital, immediately after payment, into a mixture of currencies corresponding to the SDR basket and thereafter to hold it in that form.
3. Where the option in paragraph 2 is not exercised, the arrangements for maintaining the value of paid-in capital shall be as follows:
 - Settlements in favour of the Bank or in favour of members shall be made on the occasion of changes in the amount of capital of the Bank, (or in any case at intervals of 3 years if the period between such changes is longer), provided that net changes in currency exchange rates against the SDR since the preceding settlements exceed 3 per cent upwards or downwards. During the twelve months following such settlements, the Bank will make payments to members whose currencies have appreciated. In the case of members whose currencies have depreciated, if they choose not to make the appropriate maintenance of value payments within that period, the corresponding voting power of those members shall be suspended at the end of the twelve month period. Such members will continue to have the option to restore their voting power by means of maintenance of value payments at any time during a further period of 2 years. If they do not do so within that period, the proportionate number of shares and voting rights will be withdrawn from that member and offered for subscription by other members within the framework of a future selective capital increase.

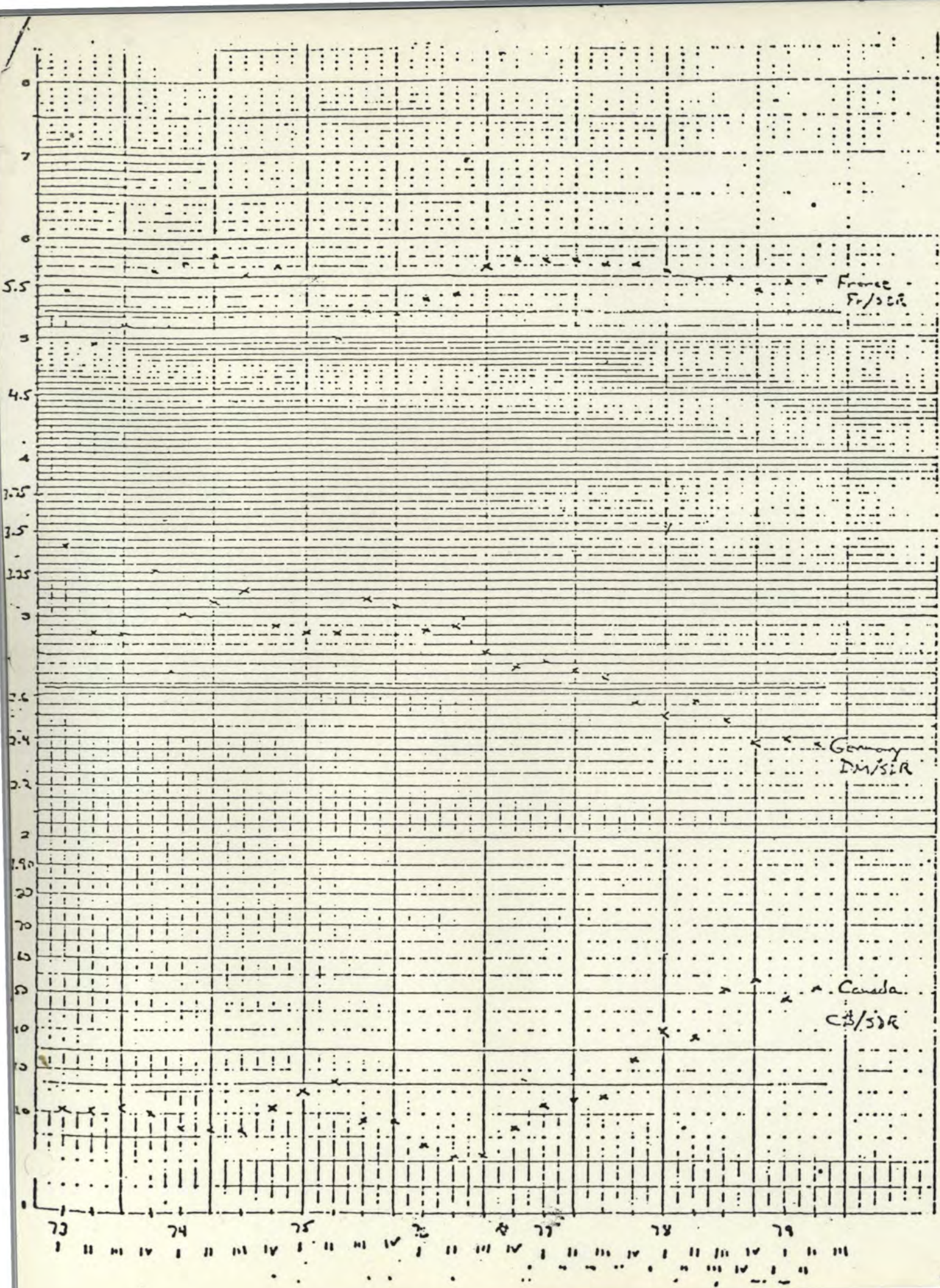
4. The callable capital shall at all times be subject to call up to its full SDR value which implies adjustments to the amounts of callable capital obligations in terms of national currencies corresponding to the appreciations or depreciations against the SDR. However, this rule will be subject to the following exception:

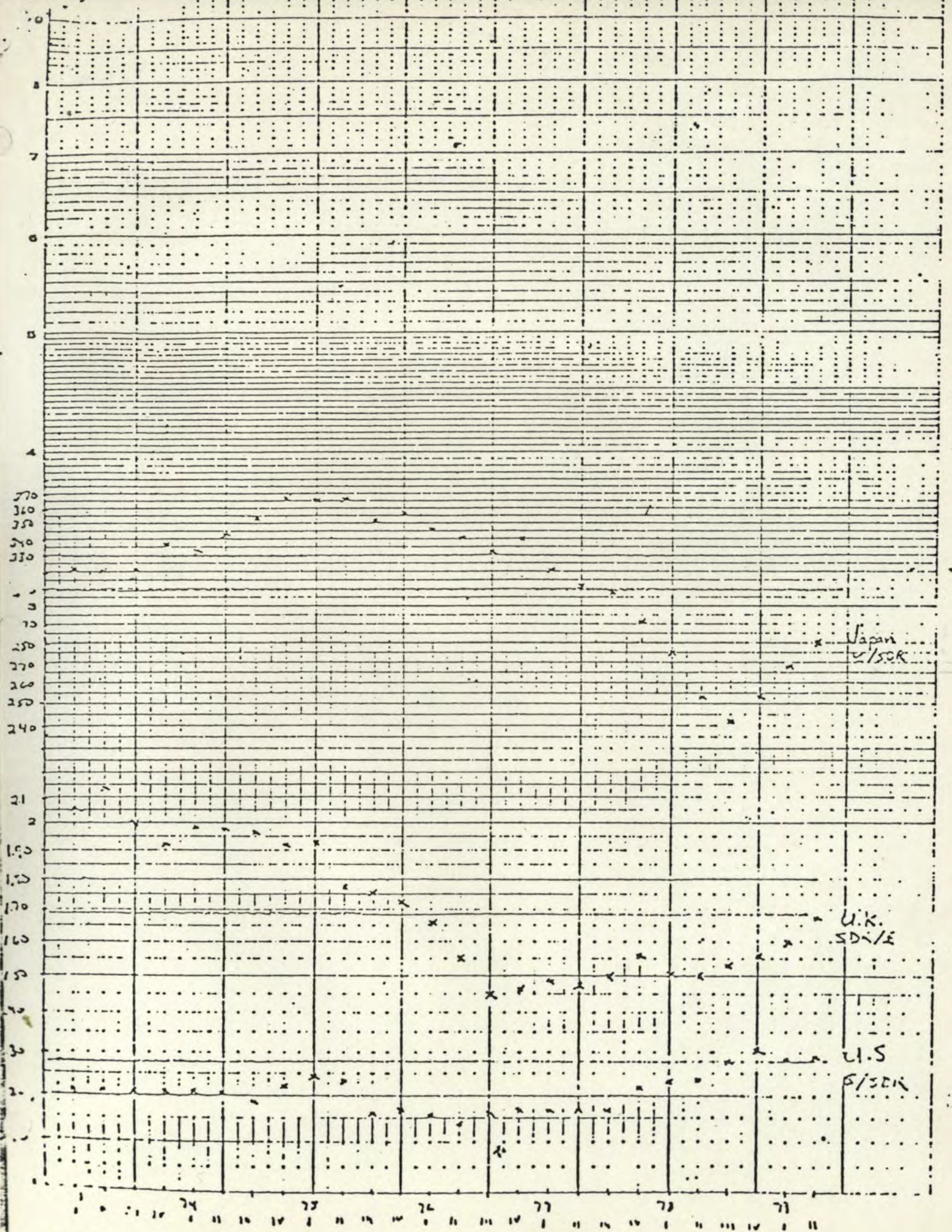
If a Member so wishes it may opt for a ceiling on its callable capital obligation in terms of its national currency. If the currency of such a member depreciates by more than 3 per cent net since the preceding settlement it will have the right either to undertake additional callable capital obligations in terms of its national currency in accordance with its own budgetary procedures and requirements, or to accept a corresponding diminution in its shareholding and voting power. As in the case of paid-in capital, there will be an initial period of twelve months during which Members with depreciated currencies will be obliged to make this choice; and if they do not increase their callable capital obligations within this period a corresponding portion of their voting rights will be suspended but they will still have the right to restore them by undertaking the necessary callable capital obligations during a further period of 2 years.

In the case of a call within the 3-year period following the last MoV settlement, the ceiling in national currency would be the upper limit of liability.

5. This proposal is without prejudice to the question of obligations for the period since 1971.

cc: Mr. Bergsten
Mr. Joyce
Mr. Cargill





Japan
SDR/E

U.K.
SDR/E

U.S.
SDR/E

OFFICE MEMORANDUM

TO: Messrs. RYRIE, KURTH, MORIOKA

DATE: November 26, 1979

FROM: Paul MENTRE de LOYE, Executive Director for France

SUBJECT: Joint Proposal by France, Germany, Japan and the United Kingdom
on the Valuation of the Bank's capital

79-367

I am referring to my memorandum of November 7, 1979, on the questions of the valuation of the Bank's capital. (attachment 1).

1/ I have met Mr. Bergsten and Mr. Winder on November 20, 1979. On a purely preliminary basis, the US reactions to our proposals are the following. They include fundamental reservations on the principle of MOV itself as well as technical questions on our proposal.

a) Fundamental reservations :

- The US Treasury is convinced that MOV is neither useful nor necessary to maintain the financial soundness of the Bank and its access to financial markets.

- The US Treasury agrees to use SDR as a unit of account, but in a world of rapid exchange rates movements, it is difficult to conceive that fundamental adjustments, such as relative voting powers, should be determined automatically and solely by relations between individual currencies and SDR. There are many other factors that should be taken into account in determining appropriate capital shares ; in fact, exchange rates fluctuations are often perverse and do not reflect changes in real economic conditions.

- In the US system, it would be very difficult to persuade the Congress that either it would have to accept in advance additional appropriations or that the number of shares to be purchased by a given appropriation expressed in dollars would not be fixed.

b) Technical questions

- Is, in our proposal, the MOV principle applicable to the period preceding encashment ? and, furthermore, after encashment, does the MOV principle apply at the same time to paid-in-capital and to callable capital ?

- How is ensured the symmetry between appreciating currencies and depreciating currencies ? More specifically, does the repayment to appreciating countries imply a decapitalization of the Bank and how the netting between periods of appreciation and periods of depreciation for any given currency is ensured ?

- As it appears from simulation (attachment 2), the three per cent threshold would not have played a role frequently for the US dollar, but very frequently for the other currencies. Therefore, this band of three per cent appears so narrow as to render its usefulness questionable.

In order to avoid uncertainties, would it be possible to know in advance what will be the policies of individual countries under our proposal ?

2/ I had, on the 26, a telephone conversation with Mr. Hilton, in the Canadian Treasury. Basically, the Canadians have three reservations :

- They consider that SDR should be a unit of account and not a standard of value.

- As far as the paid-in capital is concerned, the equivalent in national currency, at the date of the agreement of a given amount of SDR, should be maintained. However, if exchange rates fluctuations were such as to appreciably erode the financial basis of the Bank, negotiations might be reopened to discuss various possible solutions.

- As far as callable capital is concerned, the application of the MOV by additional subscription or by reduction of voting power is not unreasonable, but these adjustments should take place only at the time of changes in the amount of the capital of the Bank.

Like the US views, these Canadian views are at this stage preliminary and tentative.

3/ The US delegation and the Canadian delegation will stand ready to present more elaborate views in the Paris meeting on December 11, 1979.

cc : Mr. BERGSTEN
Mr. JOYCE
Mr. CARGILL
Mr. DRAKE

Messrs Ryrle, Kurth, Morioka

DATE: November 7, 1979

Paul Mentré de Loye, Executive Director for France

71

Joint Proposal by France, Germany, Japan, and the United Kingdom
on the valuation of the Bank's capital.

As you know, it was agreed in Belgrade that the Joint Proposal by France, Germany, Japan and the United Kingdom on the valuation of the Bank's capital (attached to the present memorandum) will be first transmitted to M. Bergsten (U.S.A.) and M. Joyce (Canada), which was done in Dubrovnik. It was furthermore agreed that I would try to get initial reactions from M. Bergsten and M. Joyce and convey them to M. Cargill while at the same time asking him for a study of the legal implications of the proposal.

M. Bergsten said to me that the U.S. Treasury is still in no position to indicate its initial reactions to our paper since it intends, noticeably, to make simulations on the way in which a three-per cent threshold would have played in the past and since it has yet to ascertain more fundamental reservations.

Under these circumstances, I have submitted last week to M. Cargill our proposal, without additional comments. M. Cargill agreed to have the legal implications of the paper studied. In addition, he agreed to prepare a paper on the various financial and legal possibilities which are open to deal with the question of obligations for the period between 1971 and the date of application of new rules.

At the end of the month, I will try to get the initial reactions of the U.S. and of the Canadians and convey them to yourselves and M. Cargill, in order to speed up the process of the working group which will meet in Paris in December at the time of the IDA Replenishment Meeting.

copies for information:
M. Drake
U.S. Executive Director
M. Cargill

Prepare a white paper based on the discussion outlined here. Book to do by 1/15?

present the problem, alternative solutions with quantitated outcomes

Questions and Answers
7 Jan effects of other changes; 2 1/2 2 Proposed views of the solutions
Valuation of IBRD Capital Subscriptions

Why is maintenance of value (MOV) important?

In the strict application of term, MOV in the Bank's Articles refers to payments to and from the Bank that are intended to maintain the value of the national currency portion of paid-in capital against gold or gold's successor as an international standard of value. MOV in this sense is not particularly important to the Bank. Its financial performance would be little affected by abolition of MOV on paid-in capital, and any deleterious effects could be mitigated by changes in the Bank's financial practices. The reason for the relatively small effects of MOV is simple: the basket of currencies making up the Bank's released paid-in capital is similar to the SDR basket. Fixing the value of released paid-in in terms of the SDR thus results in only small changes in the value of Bank equity and net income. Where MOV does make a difference is on the unreleased paid-in capital. That is, if there were no MOV, then some member countries would have an incentive to delay release of the paid-in until their currency had depreciated against the principal reserve currencies into which their subscription would be converted for use by the Bank. In this way, the real burden of the paid-in could be reduced from what it was established to be at the time of initial allocation of shares or initial subscription. If it were agreed that all paid-in capital should be released at the time of subscription, this problem could be minimized and MOV would be largely unnecessary.

Compare table listing released & unreleased amounts by country

If this is the case, why are some of the Bank's shareholders making such a fuss over MOV?

The real question is whether the Bank should have a common standard of value for its capital subscriptions. The Bank was established as a share capital institution, with voting power closely tied to the size of contribution to the Bank, i.e., to the number of shares held by individual members. Because 90% of the contribution to the Bank is in the form of a contingent liability, rather than paid-in capital, it is necessary to have some mechanism for maintaining a correspondence between relative voting power and relative contribution over time in the face of exchange rate changes. The device used in the Bank thus far has been to denominate the Bank's capital in terms of an international standard of value (i.e., the 1944 gold dollar) rather than in terms of national currency. The same correspondence could also be maintained by reallocating shares among members according to exchange rate changes; this would also shift the relative burden of the contingent liability among members, whereas the common standard keeps it fixed according to the distribution established at the time of initial share allocation (as measured by the common standard).

What are the Regs doing in US position taking up share capital

Most of the Bank's shareholders believe that the Bank should continue to have a common standard of value. In any case, they want to determine the value of an IBRD share prior to subscribing to the GCI and to know whether the fundamental principle underlying Bank voting power and subscriptions will continue to apply in the future.

DBock
November 18, 1980

Valuation of IBRD Capital Subscriptions

Discussion Outline

Bank Objectives

In resolving the issue of ~~whom~~ to value the Bank's capital we need to accomplish two objectives:

1. Retain a financially strong standard of value
2. Avoid amendment of the Articles

Our preferred solution would be to substitute the SDR for the 1944 dollar using the Directors' powers to interpret the Articles.

1. The SDR is the strongest feasible standard.
2. A good legal case can be made for substituting it without amendment.
3. It provides a common standard for subscriptions that imposes the same rights and obligations on all members.
4. This approach has been accepted by all the Bank's membership other than the US.

DB:ba

November 17, 1980

United States' Position

The US has objected to substitution of the SDR without an amendment but appears to be unconvinced of the need for a common standard of value.

US authorities have argued informally that:

1. Since the Bank's capital would be in effect denominated in a basket of currencies if there were no common standard of value, it would enjoy protection against erosion similar to what would occur if it were denominated in SDR.
2. And, any adverse effects on the Bank's financial performance can be mitigated by conversion of the paid-in into the SDR basket.

What do they also have to need to add something more to shifts in "real value" of paid-in cap & callable debt.

We should state they may oppose the "SDR solution" i.e. requires Congressional legislation & authorizing funds for a contingent risk of unavailability which they believe will be difficult to obtain.

Our response has been--and still is--that the Bank needs a strong standard of value in order to:

1. Preserve the real value of subscribed capital.
2. Maintain a correspondence between relative voting power and relative obligations.

Despite the fact that IBRD capital would be in a basket of currencies, significant (i.e., 10-15%) depreciation could occur over a five-year period.

1. The main problem rests with Part II countries' capital.
2. While the effect on paid-in capital could be kept small, the loss of commitment authority over time would be substantial.

*upward the
calculations &
assumptions*

The problem of divergence in relative voting power and obligations is especially important in the Bank because 90% or more of the total subscription (upon which voting power is based) is not paid in.

1. In IDA or the Common Fund, the reverse is true and mismatches of relative obligations and votes caused by exchange rate movements after subscription are minor in comparison to the Bank.
2. The US itself has been fighting to preserve weighted voting in international organizations; abandonment of a common standard for Bank capital would weaken their position.

Apart from lack of conviction about the need for an IBRD standard of value, substitution of the SDR for the 1944 dollar has some important administrative and political implications for shareholders in general that have particularly troubled the US.

1. Adoption of the SDR would require the US to settle large MOV obligations on existing capital that have accrued since July 1, 1974 (when the SDR was redefined). *how much*
2. The US will have to cope with a contingent liability that remains uncertain in terms of US dollars:
 - this can't be handled in the same way as the IMF subscription where the exchange of assets principle applies;
 - but it is no different from a foreign borrowing denominated in something other than the dollar;
 - the fact that the US no longer intends to fully appropriate callable helps but does not remove the need to accept an unknown contingent liability.
3. Administrative/accounting problems with MOV on the paid-in capital were an issue at one time but we think the US now recognizes that these can be handled through the "Philippine formula". *meaning?*

Options:
1. SDR for existing + future shares 10 same but with option to buy
2. 1.70 SDR + SDR for future shares 20 or for future shares
3. Local currency 10 SDR currency SDR

Compromise Proposals--Paid-In Capital

US objections to the SDR as it affects their paid-in capital can be dealt with on new subscriptions through application of the "Philippine formula". This would not, however, eliminate the need to settle MOV on existing shares.

how

Adoption of the current US dollar as the standard of value--which has a reasonable legal basis--would solve the US problem with respect to both existing and new subscriptions.

1. The US paid-in capital would be "self-maintaining", since the 9% funds would be paid in the standard of value.
2. As the US has settled all MOV at the last par value of the US dollar, this solution would eliminate any further obligation on existing capital.
3. But other shareholders find this unacceptable, since it puts the US in a privileged position, even though it would require smaller MOV payments by non-US shareholders to the Bank than would the SDR.

(with adjust.) also rather than add (pay'ts) ← but would require agreement to this

One approach that might prove acceptable to the US would be: (a) either the US dollar or SDR for the existing capital; and (b) SDR only for the future (combined with "Philippine formula").

Flesh out with numerical examples to effect on the US & others (MOV for pay'ts + voting changes) of the alternatives

but would require agreement to this require legislation if this would not work legis. be easy to pass

Compromise Proposals—Callable

Again, substitution of the US dollar would solve the problem for the US of ancontingent liability that is unknown in US dollar terms, but other shareholders are not likely to accept this solution.

The Bank would also be worse off with the US dollar as the standard because of its weakness vis-a-vis the SDR, but not unacceptably so.

There is some doubt as to how serious the legal and administrative problem of an undefined contingent liability is for the US, and it may not be wise to compromise too much at this time.

However, the answer to the US objection lies in permitting the US to fix the US dollar amount of its callable capital while retaining the SDR as the standard of value.

1. This would eliminate any risk of the US contingent liability being in excess of what is authorized (or appropriated).
2. But it would require (or permit) periodic adjustment of either:
(a) the US dollar amount of callable capital to bring it into line with the SDR amount; or (b) the number of shares held by the US.

*] would
this require
legislation*

The European Joint Proposal on this issue provides for periodic adjustment of all shareholdings.

1. Total Bank subscriptions would remain constant in SDR terms.
2. But there is no legal basis for taking shares away from members; thus, this approach could require unanimous agreement.

A simpler approach suggested by Legal would repurchase shares from the US only as requested by US authorities in order to maintain a particular US dollar callable.

A variant of the Joint Proposal would be to fix subscriptions for (say) five-year intervals in terms of one of the SDR currencies selected by the member, making adjustments every five years in callable capital or shareholdings so as to reestablish the relationship required by SDR-denominated capital.

Conclusion

The preceding considerations suggest:

1. The Bank should take a firm stand on the need for a common standard of value for capital subscriptions.
2. While it would be preferable to have the SDR be that standard --and to substitute it for the 1944 dollar by interpretation-- the current US dollar would work fairly well from the Bank's standpoint.
3. The US objections to the SDR for future subscriptions can be dealt with as long as:
 - (a) the US does not insist on amendment as a matter of principle;
 - (b) the US does not refuse (again as a matter of principle,) to accept a contingent liability that is unknown in terms of US dollars.

] it will
refuse

6

ROUTING SLIP		DATE: November 14, 1980
NAME		ROOM NO.
✓ Mr. Joseph Wood		D-1326
Mr. Paul Applegarth		C-1204
Mr. David Bock		D-1310
Mr. Hugh Scott		N-735
Mr. Victor Chang		I 4-100
APPROPRIATE DISPOSITION	NOTE AND RETURN	
APPROVAL	NOTE AND SEND ON	
CLEARANCE	PER OUR CONVERSATION	
COMMENT	PER YOUR REQUEST	
FOR ACTION	PREPARE REPLY	
INFORMATION	RECOMMENDATION	
INITIAL	SIGNATURE	
NOTE AND FILE	URGENT	
REMARKS:		
<p style="text-align: center;">At Mr. Scott's request I am sending you herewith a draft dated November 14, 1980 on options available to us for the valuation of capital issue. Some Annexes are not included.</p>		
FROM: Lester Nurick <i>LN</i>	ROOM NO.: N-635	EXTENSION: 61494

VALUATION OF CAPITAL: OPTIONS

I. Introduction

This note describes the basic questions raised about valuation of the Bank's capital, particularly by the U.S., and suggests several options for handling it. In considering the matter of valuation of capital, particularly in respect to the U.S. position, it should be realized that there are several different components to it. Sometimes the differences between these components gets blurred, and there is a resultant confusion of both analysis and terminology. For example, the issue is often referred to simply as a matter of maintenance of value. In fact, the issues involve, strictly speaking, more than maintenance of value and this should be recognized.

Essentially, members have two fundamental obligations to the Bank in respect of their subscriptions to capital stock. The first obligation (which arises under Article II, Section 9) is to maintain the value of the part of the paid-in portion of their subscription which is held by the Bank in terms of the "United States dollars of the weight and fineness in effect on July 1, 1944" (1944 dollars). Under the Articles this obligation accrues when the par value of the member's currency involved is reduced or the foreign exchange value of its currency has significantly depreciated and it requires the member to make compensating payments to the Bank. The Bank has the converse obligation to the member if the par value of the member's currency involved is increased. Beginning in March 1973 several members established central rates in lieu of par values and the majority of members instituted a system of floating rates. The Bank decided to settle maintenance of value obligations with members establishing central rates,

*what
is a
central
rate*

but to defer the application of the maintenance of value provisions of the Articles to the other members until such time as the issues involved were determined. With the demise of the 1944 dollar on April 1, 1978 and the abolition of the par value system on which it was based, it became necessary to decide the basis for determining the amount of the obligations involved. This determination has not yet been made, although the General Counsel has given an opinion concluding, in effect, that as a legal matter of interpretation the 1944 dollar has been replaced by the SDR. The General Counsel has also stated, however, that the Bank could decide that the 1944 dollar should be taken to mean 1.20635 current dollars (the par value of the dollar on March 31, 1978), with the consequence that maintenance of value should be measured by that standard.

The second obligation arises with respect to the callable capital component of members' subscriptions. This obligation requires members to respond to calls, if and when made, on this portion of their subscriptions, up to the amount of this portion also valued in terms of the 1944 dollar. Members accept this obligation when they subscribe to shares. Before a call is made, no payment need be made by the member to the Bank.

In addition, it should be noted that there may be a difference between the way in which we can, or should, handle the valuation of existing shares and the valuation of new shares. Existing shares have all been subscribed at a uniform price (\$100,000 in terms of 1944 dollars). The price of the shares to be subscribed under the General Capital Increase (the GCI) has also been fixed at the same price, but there may be greater flexibility in dealing with the pricing of these shares and shares subscribed thereafter. (See Section , below)

II. Position of the United States

While the position of the U.S. on the question of valuation of capital is not completely clear, the U.S. seems to be taking the following position:

1. The U.S. objects to having an open-ended commitment which would arise if the SDR were adopted, by interpretation, as a unit of value.

2. The U.S. takes the view that in view of the change in the international monetary system since Bretton Woods it is no longer appropriate to have a maintenance of value system and no longer appropriate to have members' obligations on their subscriptions determined on the basis of a common unit of value. In this connection they say that a formal system of maintenance of value is not necessary to protect the Bank, pointing out that if the Bank held a mix of currencies (some appreciating and some depreciating against the SDR) the capital of the Bank would be substantially protected. They contend that the voting power of any member should not be affected by changes in the value of its currency after it subscribes to shares, as is the case in IDA. They seem to want their obligation to be fixed only in terms of the U.S. dollar, and not in terms of any other unit of value. As a corollary of this position the U.S. seems to be objecting not only to an interpretation of the EDs adopting the SDR as the unit of value, but also an amendment to the same effect. (It is interesting to note that when Charles Cooper was the U.S. ED, the U.S. Administration (a Republic one) was not opposed to using the SDR as the unit of value, but was opposed to a Bank decision to use the SDR as a unit of value by way of an interpretation of the Articles.)

III. Options

The following describes a number of options which we should consider in trying to resolve this issue.

1. The EDs decide, by interpretation that the SDR is the unit of value.

2. The EDs decide, [by interpretation,] that (a) existing shares be valued, at the option of the member, either in dollars at 1.20635 or in SDRs, and (b) new shares (under the GCI) be valued in SDRs.

3. The EDs decide by interpretation that the SDR is the unit of value (as in (1) above). The EDs also adopt a scheme whereby the U.S. would be permitted to sell its shares so as to keep their obligations thereon limited to amounts authorized, that is to say, amounts based on a valuation in terms of dollars at 1.20635.

Option 1

The argument for the SDR interpretation is as follows: In the first place, as noted above, the General Counsel has given an opinion that the 1944 dollar should be read as referring to the SDR and that the maintenance of value obligations should be measured in terms of the SDR. In the second place, it seems clear that almost all (maybe all) the major members of the Bank, other than the U.S., would be in favor of adopting such an interpretation if that were acceptable to the U.S. These members believe that the SDR is the logical successor to the 1944 dollar and they seem to be in favor of retaining the principle of maintenance of value. Third, it would be a clear and definite decision which should be understandable by and acceptable to creditors. And finally, the staff's analysis concludes that the Bank would be hurt if it gave up maintenance of value for several reasons:

(i) the Bank's capital would be eroded and the Bank's lending limit thereby reduced [see Annex ___]; and (ii) the burden-sharing principle on which voting power is based would be distorted. Also, to give up maintenance of value would [probably] require an amendment to the Articles.

The objections of the U.S. to the adoption by interpretation of the SDR as the unit of value seem to be the following. The U.S. asserts that it will not assume an obligation to pay money to the Bank which has not been approved by Congress, that is to say, it will not agree to an open-ended commitment in terms of SDRs because Congress has only approved a commitment in dollars. In this connection, the U.S. asserts that under the par value system it had control over the scope of its obligations, since it had control over whether or not to change the par value of the dollar. It also asserts that the adoption of the SDR as the unit of value can, as a legal matter, only be done by amendment, not by interpretation. It refuses to regard as a precedent its SDR commitment in the Fund on the following grounds; first, as to its existing quotas, the U.S. contends that it has accepted by legislation ^{1/} the amendment to the Fund's Articles which substituted the SDR for the gold dollar and thus imposed an SDR maintenance of value obligation on the U.S.; and second, as to the current increase in its quota, legislation for which is now pending in Congress, there will be legislation specifically authorizing the U.S. quota increase in terms of the SDR and making an appropriation therefor.

^{1/} As far as we know, the U.S. has not said that it would be legally or otherwise improper to adopt the dollar as the unit of value by interpretation. The arguments of the U.S. are essentially based on political considerations. It would seem that the U.S. could readily abandon its contention that the interpretation route is illegal, if it liked the interpretation.

As a strictly legal matter, it would be possible for the EDs to override the U.S. objection and approve, by majority vote, a decision of interpretation adopting the SDR as the unit of value; in that case the U.S. would be legally bound,^{2/} as much so as if the Bank's Articles of Agreement were amended to that effect. However, there seems to be no disposition on the part of the other members of the G-6 to take that step in the face of the adamant position of the U.S. Therefore, as a tactical matter we should try again at an appropriate time (that is to say, soon) to get the U.S. to agree to such a decision on the ground that it would be in the best interests of the Bank.

In taking that position with the U.S. we can make several arguments:

First, the U.S. has already taken a strong stand in favor of using the SDR as a cornerstone of the international monetary system and therefore there is no reason why the U.S. as a matter of principle, should now object to its use in the Bank. (Annex B [evidence])

Second, as far as the legislative objections of the U.S. are concerned, the action taken by the U.S. in the IMF shows that the fears of the U.S. are exaggerated. In brief, in the IMF the U.S. has accepted open-ended obligations based on the SDR in respect of its existing quota and, as far as its new quota increase is concerned, has obtained authorizing legislation based on the SDR and the House has passed an appropriation bill in terms of an SDR commitment (Appendix C summarizes the legislative action taken). The record does not show any Congressional opposition to the use of the SDR.

^{2/} It would nevertheless be possible that, if the EDs took that action, the U.S. would advise the Bank that it did not regard the decision as binding on it. This would leave us in a most undesirable position because it would cloud the U.S. liability on callable capital and require us to make a statement about it in our prospectus.

And finally, it seems clear that both the Administration and Congress (at least the present ones) will support a U.S. commitment for callable capital without providing for an appropriation of the amount involved; this course of action removes a major concern of the U.S.

(this is in pending legislation;
however, there is a legislated limit on authority given to
assume a obligation)

OPTION II

This course represents a compromise under which (i) existing shares would be valued, at the option of the member, either in dollars at the rate of \$1.20635 per 1944 dollar or in SDRs; and (ii) new shares (including the GCI shares) would be valued in SDRs. This course would permit the U.S. to have its obligations on existing shares fixed as of March 1, 1978 and would therefore not require additional appropriations. But it would also require the U.S. to incur SDR obligations for new shares, including shares under the GCI.

Some of the problems raised by this option and the implementation of it are as follows:

A. Existing shares

Legality: The General Counsel, as noted above, has given an opinion concluding that the SDR is, as a matter of interpretation of the Articles of Agreement, the successor to the 1944 dollar. He has also stated, however, that the EDs could conclude that the 1944 dollar would be taken to mean 1.20635 current dollars, with the consequence that maintenance of value would be measured by that standard. In this connection, the General Counsel also advised the Audit Committee () that under the Articles there must be a "common" standard of value and that an amendment of the Articles would be required to abolish it.

The question is raised whether it would be legally possible for the EDs to decide that existing shares would be valued, at the option of each member, either in the SDR or the 1944 dollars at the rate of 1.20635.

The General Counsel noted that adoption of the 1944 dollar at the \$1.20635 rate would impose a maintenance of value obligation on all countries

give countries
until 1983
(5 years for
GCI, 1978)
to move from
1.20635 to
SDR 1

except the U.S., but nevertheless concluded that it would be legally possible for the EDs to make that decision because among other things the issue involved was essentially one of the mutual rights and obligations of members. A decision by the EDs to permit members to choose, at the option of each member, either the SDR or the 1944 dollar at the \$1.20635 rate, would also mean that all members except the U.S. (assuming the U.S. chose the 1944 dollar at the \$1.20635 rate) would have a maintenance of value obligation in terms of a standard of value other than its own currency. The only difference is that members would be given an additional option, that is, the option to choose the SDR as well as the 1944 dollar at the \$1.20635 rate, but the maintenance of value system would be preserved. Since under the General Counsel's opinion adoption of either the SDR or the 1944 dollar at the \$1.20635 rate would be legally possible, there appears to be no legal objection to giving members an option to choose either of the two standards of value. Adoption of such a system would not appear to be inconsistent with having a common standard of value.

Implementation of the Option

If members are given the option to decide whether to fix their obligations either under the SDR or at the 1944 dollar at the \$1.20635 rate, it can be assumed that members will choose that price which they believe will result in the least burden on them, unless they decide to choose the SDR as a matter of principle. (Annex ___ shows as of _____, the rates of the major currencies against the SDR and the 1944 dollar at the \$1.20635 rate [brief analysis of the Annex].)

Maintenance of Value Obligations on Paid-in Capital

(i) The United States

It is assumed, of course, that the U.S. will opt to value its shares in terms of the 1944 dollar at \$1.20635. Since the U.S. has made payment of the paid-in portion of its subscription at that rate (including maintenance of value payments on the two occasions when it devalued the dollar resulting in changes in the par value of the dollar) and since its maintenance of value obligations will be measured against the dollar at that rate, it will not incur any further maintenance of value obligation on the paid in portion of its capital subscription. Thus, regardless of any fluctuations of the dollar against the SDR, as noted above, the U.S. will not need to obtain any additional appropriation in respect of this portion of its subscription.

(ii) Other Members

Members other than the U.S. would be obliged to maintain the value of the paid-in portion of their subscriptions in terms of the 1944 dollar at the rate of \$1.20635 or the SDR depending on the option they choose. Thus if the amount paid in by a member on account of its subscription was less or more than the dollar equivalent or the SDR equivalent thereof at any relevant time a maintenance of value obligation running to or from the Bank would accrue. This obligation, whether running from the member to the Bank or vice versa, would be measured daily and therefore would constantly change depending on exchange rate movements. Settlement of these obligations, however, could be deferred, as it has been in the past. (See)
(Annex ___ shows the maintenance of value obligations, as of ,
for certain countries both in terms of the dollar and the SDR.)

Obligation on Callable Capital

(1) The United States

All shares subscribed to date by the U.S. (and all other members) have been expressed in terms of 1944 dollars. If the Bank decides that the 1944 dollar is to be taken to mean 1.20635 current dollars, the total subscription of the U.S. would amount to the number of shares it has subscribed (70,583) multiplied by \$120,635, or [\$8,516,050,699]. Its callable capital portion is 90% of that amount [\$7,664,445,630] and that amount would represent its maximum obligation on that portion. In fact the U.S. has already fully appropriated that amount and, even if the U.S. decided it wanted to continue the policy of having its callable portion fully covered by an appropriation, it would not be required to appropriate any further amounts.

(ii) Other Members

The callable capital portion of the subscriptions of all members other than the U.S. will, under this option, be expressed and measured in terms of the dollar at the rate of \$1.20635 or the SDR, as the case may be. In either case, their obligation on the callable capital portion of their subscriptions will fluctuate, as in the case of the paid-in portion, depending on the rate of exchange of the currency of the member involved against the dollar or the SDR, as the case may be.

[Add section on effect of option on financial statements (including any consequent write-offs, and on lending limit.)]

B. New Shares

Under this option, new shares (including shares to be subscribed under the GCI) would be priced and valued in terms of SDRs. The price of each share would be SDR 100,000. If this were done, it would be necessary to amend the GCI Resolution. Whether this would present legislative problems to members would have to be explored.

Under this option the U.S. would be obliged to commit itself in terms of SDRs, as it will be obliged to do in the case of the IMF. The obligations of other members would be the same, but, as noted above, this should not be a problem for them since they already have assumed obligations in terms of the 1944 dollar.

Option III

The EDs decide by interpretation that the SDR is the unit of value. The EDs also adopt a scheme whereby the U.S. would be permitted to sell its shares so as to keep their obligations thereon limited to amounts authorized, that is to say, amounts based on a valuation in terms of dollars at 1.20635.

Under the option the Bank would adopt an interpretation that the SDR is unit of value for Bank capital, but would permit the U.S., from time to time if the U.S. dollar depreciates against the SDR, to sell enough shares to the Bank so that its obligation in respect of the callable capital portion of its subscription would not be greater in terms of dollars than the amount already authorized (and appropriated, if that is still regarded as necessary by the U.S.). This means that the U.S. commitment in respect of the callable capital portion would always be fully covered by legislation and therefore the U.S. would not have to enact additional legislation to cover its commitment on callable capital. This also means that, as the U.S. sells its shares, it would lose relative voting power and the U.S. objects to this.

The obligation of the U.S. for maintenance of value on its paid-in portion presents different complications. As noted in other memoranda we have written, this obligation can in part be avoided by various devices and in part be deferred indefinitely. (The details of implementation of this option are described in a Legal Department memorandum, dated February 6, 1980 which was given to the G-6.)

This option, while attractive in certain respects, presents a number of difficulties to the Bank. It would result in a continuous decrease in capital if the U.S. dollar continues to depreciate against the SDR, unless other countries were willing to subscribe enough capital to compensate

for the decrease. Therefore, this might reduce the Bank's lending limit and might raise questions with bondholders. In my view, this is the least attractive of the three options described in this paper.

DRAFT
LNurick:mr
November 14, 1980

ANNEX

IMF: U.S. Quota Increase; Legislation

Authorization

An authorization act has been passed (P.L. 96-389; October 7, 1980) providing that the U.S. Governor is "authorized to consent to an increase in the quota of the U.S. in the Fund equivalent to 4,202.5 million SDRs, limited to such amounts as are appropriated in advance in Appropriations Acts."

The Report of the National Advisory Council (November 1979; page 18) to Congress recommending the increase in quota stated that the U.S. quota in the Fund is denominated in SDRs, the unit of account of the IMF in which all members financial rights and obligations are established. "Its U.S. dollar and foreign currency exchange value fluctuate daily with fluctuation in exchange rates. Consequently, a fixed U.S. dollar value cannot be determined for the U.S. quota increase until the date the quota increased takes effect in the Fund. The authorization for U.S. consent to the quota increase therefore would be expressed in SDR."

Appropriation

1. The House, on September 25, 1980 approved an appropriation for the increase in the U.S. IMF quota providing as follows:

For an increase to the United States quota in the International Monetary Fund, the dollar equivalent of 4,202.5 million Special Drawing Rights (approximately \$5,537,839,000), to remain available until expended, and balances equivalent to the current SDR value of the United States quota in the Fund shall be merged with this appropriation. Amounts equivalent to the United States reserve position in the Fund shall be credited to this appropriation. Amounts available in this account may be transferred to the Fund by the Secretary of the Treasury to meet United States obligations in the Fund in an amount not to exceed at any time the United States quota in the Fund. The amounts provided for valuation adjustments of Fund holdings of United States dollars shall continue to be available for transfers to this appropriation account for the purpose of such adjustments. (H.J. Res. 601)

The Report of the House Committee on Appropriations (Report No. 96-1263; dated August 28, 1980) stated as follows:

The Committee is recommending an appropriation of budget authority of the dollar equivalent of 4,202,500,000 in Special Drawing Rights^{1/} or approximately \$5,500,000,000, to the International Monetary Fund. This appropriation will result in no actual net spending or outlays but budget authority only; thus there is no net cost to the U.S. taxpayer.

2. The Senate has not yet enacted an appropriation.

Comment

We know that the U.S. administration had difficulties in deciding how to treat the IMF authorization and appropriation, partly because they realized it would be regarded as a precedent for action in the Bank. The U.S. was obliged to commit itself to the Fund in terms of an SDR obligation. Without going into all the details involved regarding the budgetary treatment involved, the House has enacted an appropriation bill providing for a full appropriation of dollars equivalent to the U.S. quota increase, including any maintenance of value payments that have to be made by the U.S. The legislative history of both the Authorization act and the Appropriations bill does not indicate any Congressional opposition to this open-ended commitment in terms of SDRs. The legislative history also shows that the U.S. wanted a commitment in terms of the SDR in order

1/ The U.S. quota in the IMF is denominated in Special Drawing Rights (SDR), the unit of account of the IMF in which all members' financial rights and obligations are established. The SDR is based on the exchange value of a basket of 16 currencies. Its U.S. dollar and foreign currency value fluctuates daily with fluctuations in exchange rates. Consequently, a fixed U.S. dollar value cannot be determined for the U.S. quota increase until the date the quota increase takes effect in the Fund (which requires consent to quota increases by members having not less than 75 percent of the total quotas of the Fund). The appropriation for U.S. consent to the quota increase therefore is expressed in SDR.

to maintain its "quota share and influence over INF decisions." Thus, Secretary Miller stated to the Senate Appropriations Sub-Committee as follows:

Also under either approach, it is important that the appropriations action be denominated in SDR, though I know this is a departure from normal practice. This is because our IMF quota--and those of all other countries--is denominated in SDR, the IMF's unit of account. We negotiated hard to maintain our quota share and influence over IMF decisions. There were many who sought increases in their own shares at our expense. We should not allow a cut through inadvertence, which could happen if the appropriation number were expressed in dollars and the dollar depreciated in terms of the SDR. An SDR denomination of the appropriation figure--SDR 4,202.5 million--will protect us against that danger.